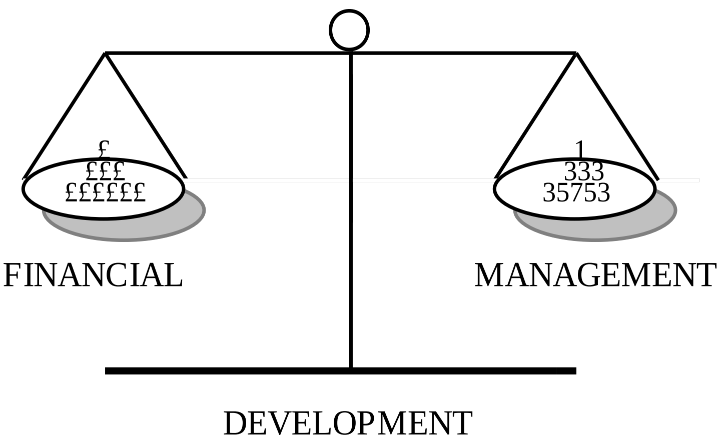
FINANCIAL MANAGEMENT DEVELOPMENT

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

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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.

ACCRUALS	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.
ADDED VALUE	The value added e.g. sales less bought-in materials and services.
ASSETS	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.
ASSET TURNOVER	Sales divided by assets employed.
AUDITORS	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.
BALANCE SHEET	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.
BOOK VALUE	The value at which Fixed Assets are stated in the Balance Sheet i.e. cost less any depreciation (also called net book value).
BORROWINGS	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.
BREAK-EVEN POINT	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.
BUDGET	General term for a short (normally one year) financial plan.
BUDGETARY CONTROL	The process by which actual performance is measured against the budget. This normally requires Variance Analysis.

CAPITAL EMPLOYED	Amount of financial (share or loan capital) put into a company and on which the management must make a return.
CAPITAL EXPENDITURE	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.
CASH FLOW	The change in the cash position of a business during an accounting period or as a result of a particular event.
CASH FLOW STATEMENT	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.
CAPITAL RESERVE	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.
CAPITAL TURNOVER	Also called Asset Turnover. Sales divided by capital employed.
CONTRIBUTION	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.
COSTS	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.
CREDITORS	Amounts owing to suppliers for bills unpaid at a point in time e.g. at the end of a financial period.
CURRENT ASSETS	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.

CURRENT LIABILITIES	Amount owing at the period end which will or could be required to be paid within twelve months.
DEBT EQUITY RATIO	Referred to as either Debt/Equity ratio or Gearing ratio. Ratio of borrowings to shareholders equity.
DEBTORS	An asset in the Balance Sheet which represents amounts owing by customers, e.g. sales invoices not yet paid.
DEPRECIATION	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.
DIRECT COSTS	Those costs which can be directly identified with a product, business unit, department or other part of the business.
DISCOUNTED CASH FLOW	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.
DIVIDEND	The amount of cash paid or payable to shareholders as a distribution of profits.
EARNINGS	Profit available to ordinary shareholders after all charges except dividend. Technically it is always after tax, but can sometimes be used to mean profits.
EARNINGS PER SHARE (EPS)	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 extra-ordinary items.
EBITDA	Earnings before Interest, Tax, Depreciation and Amortisation. Effectively this is the cash produced by operations. It is used as a performance measure to help comparison between different businesses.
EQUITY	The investment in the business by shareholders.

EXPENSES	Also known as Revenue Expenditure. This is another term for costs, sometimes only applied to those costs below the gross profit level.
EXTRA-ORDINARY ITEM	An item in the Profit and Loss Account which is unconnected with ordinary operations.
FINANCIAL ACCOUNTS	The accounts prepared for inclusion in the Annual Report to Shareholders.
FIXED ASSETS	Those assets which are retained for long term use in the business.
FIXED COSTS	Costs where the total amount spent does not vary directly with volume in the short-term.
FINANCIAL REPORTING STANDARD	Formerly called SSAP (Statements of Standard Accounting Practice) these set out the rules governing published financial statements in the UK.
GEARING	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.
GEARING RATIO	Referred to as either Debt/Equity ratio or Gearing Ratio. Ratio of borrowing to shareholders' equity.
GOODWILL	The excess of price paid over the value of net assets included in the combined Balance Sheet after the acquisition of a subsidiary company.
GROSS MARGIN	Another term for GROSS PROFIT (sales less production cost). It can be expressed as a percentage of sales.
GROSS PROFIT	Sales less production cost.
HISTORICAL COST	The original cost of the asset.
INCOME	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.
INCREMENTAL COST	Also known as Marginal Cost. The increase in total cost as a result of a particular event or decision.

INDIRECT COSTS	Costs which cannot be classified as directly attributable to a product or process.
INTEREST COVER	Trading Profit divided by interest payable.
INTEREST PAYABLE	Interest payable on borrowings.
INTEREST RECEIVABLE	Interest received from investment of surplus funds.
INTERNAL RATE OF RETURN (IRR)	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.
INVENTORIES	The US term for stock.
INVESTMENTS	Shares in other companies shown as assets in the Balance Sheet.
LIABILITIES	Amounts owed by the business e.g. purchases not yet paid for.
LOAN CAPITAL	Long-term capital put into the business by lenders rather than shareholders.
MANAGEMENT ACCOUNTING	Financial information produced for the purpose of management decision making and control, rather than for reporting to shareholders.
MARGIN OF SAFETY	The amount by which sales can fall before profit equals zero, i.e. the amount above the Break Even Point.
MARGINAL COST	The short term increase in total cost as a result of a particular event or decision.
MINORITY INTEREST	Where outside shareholders hold a minority i.e. less than 50%, shareholding in a subsidiary company and are entitled to a share of profits.
NET ASSETS	Also known as Net Worth. Total assets in the Balance Sheet less all liabilities.
NET CURRENT ASSETS	Current Assets less Current Liabilities.

NET PRESENT VALUE (NPV)	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.
NET WORTH	See NET ASSETS
OPERATING CASH FLOW	The change in the cash position of a business as a result of trading operations for a particular period.
OPERATING PROFIT	Sales less all normal costs of running the business.
OPPORTUNITY COST	The amount foregone by utilising a resource i.e. its cost plus any profit it might otherwise have generated.
ORDINARY SHAREHOLDERS	Those who share equally in the profits and dividends of the business.
OVERDRAFT	Facility for short term borrowing available from bankers.
PAYABLES	The US term for Creditors.
PAYBACK	The number of years it takes to recover an initial amount invested. This may or may not be discounted.
PREFERENCE SHARE-HOLDERS	Those who have first claim on profits and dividends, usually only up to a fixed percentage of their investment.
PROFIT	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.
PROFIT AND LOSS ACCOUNT	A financial statement which records the sales, the costs and therefore the profit for a stated accounting period.
PROFIT BEFORE INTEREST AND TAX (PBIT)	Referred to as Operating Profit, Profit Before Interest and Tax, PBIT, or Trading Profit it is effectively sales less operating costs.
PROFIT MARGIN	Also known as Return on Sales. Profit as a percentage of Sales Income.

PROVISION	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.
PROVISION FOR BAD & DOUBTFUL DEBTS	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.
RATE OF RETURN	See INTERNAL RATE OF RETURN and YIELD.
RECEIVABLES	The US Term for DEBTORS (an asset in the Balance Sheet which represents amounts owing by customers).
REPLACEMENT COST	The current cost of replacing an existing fixed asset with a new asset.
RESERVES	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.
RETAINED PROFITS	All profits made since the company was formed which have not yet been distributed as dividends.
RETURN ON ASSETS (ROA)	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.
RETURN ON CAPITAL (ROC)	An abbreviated term for Return on Capital Employed.
RETURN ON CAPITAL EMPLOYED (ROCE)	Trading Profit as a percentage of capital employed.
RETURN ON INVESTMENT (ROI)	Another term for Return on Capital Employed.
RETURN ON SALES	Referred to as either Profit Margin or Return on Sales. Trading Profit as a percentage of sales.

REVALUATION RESERVE	A capital reserve caused by an increase in shareholders' equity following a revaluation of existing assets in the Balance Sheet.
REVENUE	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.
REVENUE EXPENDITURE	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.
SALES	Also known as Turnover. The amount charged for goods delivered in a particular period irrespective of whether cash has been collected.
SENSITIVITY ANALYSIS	The calculation of the impact on profit of changing assumptions.
SHARE CAPITAL	Money put into the business by shareholders by means of direct investment.
SHAREHOLDERS CAPITAL EMPLOYED	Also known as Shareholders Funds or Shareholders Equity. The total of share capital plus reserves including Retained Profit.
SHAREHOLDERS EQUITY	Another term for Shareholders Capital Employed.
SHAREHOLDERS FUNDS	Another term for Shareholders Equity.
SHORT TERM BORROWING	Borrowing which will or could need to be repaid within twelve months.
SOURCE AND USE OF FUNDS STATEMENT	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.
STOCK	The amount of money tied up in Raw materials, Work in Progress and Finished Goods.
SUNK COST	A cost which has already been paid and which therefore should be ignored when considering future actions.

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

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 forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

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, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website:
FinancialManagementDevelopment.com including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

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).

