



GLOSSARY ON ACCOUNTING TERMS



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Glossary of accounting terms



Accounting period

The time between two consecutive *balance sheet dates* (and therefore the period to which the *profit and loss account* and *cash flow statement* relate).

Accounting policies

The specific methods chosen by companies to account for certain items (e.g. stock, depreciation) subject to the guidelines of the *accounting standards*.

Accounts payable (Trade creditors)

The amount a company owes to its suppliers at any given moment.

Accounts receivable (Trade debtors)

The amount a company is owed by its customers at any given moment.

Accrual

Adjustment made at the end of an *accounting period* to *recognise expenses* that have been incurred during the period but for which no *invoice* has yet been issued.

Accruals concept

Under the accruals concept, *revenues* are *recognised* when goods or services are delivered, not when payment for those goods or services is received. Similarly, all *expenses* incurred to generate the revenues of a given *accounting period* are recognised, irrespective of whether payment has been made or not.

Accumulated depreciation/amortisation

The total *depreciation* or *amortisation* of an *asset* since the asset was purchased.

Allotted share capital (Issued share capital)

The amount of the *authorised share capital* that has actually been allotted to investors.

Amortisation

The amount by which the *book value* of an *intangible asset* is deemed to have fallen during a particular *accounting period*.

Annual report and accounts (Annual report)

The report issued annually to *shareholders* containing the *directors' report*, the *auditors' report* and the financial statements for the year.

'A' Share

Usually refers to a share which has a right to a proportion of a company's *assets* but no voting rights.

Asset

Anything of value which a company owns.

Associated undertaking (Associate)

Broadly speaking, a company is an associate of an investor company if it is not a *subsidiary* but the investor company exerts a significant influence over the company. 'Significant influence' is normally assumed to occur when the investor holds between 20% and 50% of the company.

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Audit

Annual inspection of a company's *books* and financial statements carried out by *auditors*.

Auditors

Accountants appointed to carry out a company's *audit*.

Auditors' report

Report on a company's financial statements prepared for the *shareholders* by the *auditors*.

Authorised share capital

The total number of *shares* the directors of a company have been authorised by the *shareholders* to issue.

Bad debt

Money owed by a customer which will never be paid.

Balance sheet

Statement of a company's *assets* and the *claims* over those assets at any given moment (i.e. at the *balance sheet date*).

Balance sheet date

Date at which a *balance sheet* is drawn up.

Balance sheet equation

Statement of the *fundamental principle of accounting*, whereby the *assets* of a company must equal the *claims* over those assets (i.e. the *liabilities* and *shareholders equity*).

Bond (Long-term loan, Loanstock)

A *loan* which is not due to be repaid for at least twelve months. More specifically, the bond is the certificate showing the amount and terms of the loan.

Books

The records of all the *transactions* of a company and the effect of those transactions on the company's financial position.

Book value

The value that an *asset* has in a company's *books*. The book value of an asset is usually different from its *market value*.

Capital and reserves (Equity, Shareholders' equity/funds)

The share of a company's *assets* that are 'due' to the *shareholders*. Consists of *share capital*, *share premium*, *retained profit*, and any other *reserves*.

Capital allowance

When calculating *taxable income*, the Inland Revenue takes no account of *depreciation* on *tangible fixed assets*. Instead, capital allowances are made which reduce taxable income (effectively, capital allowances are the Inland Revenue's method of depreciation).

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Capital employed (Net operating assets)

The total amount of money tied up in a business in the form of *fixed assets* and *working capital*. It is also equal to the sum of the *equity*, the *debt* and any deferred tax.

Capital expenditure

Money spent on *fixed assets* as opposed to day-to-day running expenses.

Capital structure (Financial structure, Funding structure)

The relative proportions of the funding for a company that are provided by *debt* and *equity*.

Cash flow

The change in a company's cash balance over a particular period.

Cash flow statement

A statement showing the reasons behind a company's *cash flow* during a particular *accounting period*.

Charge (Lien)

First claim over an *asset* (normally taken as *security* for a *loan*).

Class of share

Different types of *shares* are described as being different *classes*. Commercial paper
A form of *short-term loan* issued by companies requiring funds.

Consistency concept

One of the basic concepts of accounting: the accounting treatment of all items should be consistent from one *accounting period* to the next.

Consolidated accounts

Accounts prepared for a *parent company* and its *subsidiaries* as if the parent company and the subsidiaries were all just one company.

Contingent liability

A *liability* which may or may not arise depending on the outcome of some future event.

Convertible loanstock/bond

A *loan* which the lender can convert into *shares* in the company rather than accepting repayment of the loan.

Convertible preference share

A *preference share* which can be converted by the holder into *ordinary shares* in the company.

Corporation tax

The tax paid by a company on its profits.

Cost of goods sold (Cost of sales)

All materials costs and *expenses* which can be directly ascribed to the production of the goods sold.

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Coupon

1. The *interest* payable on a bond.
2. The *dividend* payable on a *preference share*.

Covenant

Restriction imposed by a lender, breach of which normally enables the lender to demand immediate repayment of the *debt*.

Credit

1. Time given to a customer to pay for goods or services supplied.
2. In *double entry book-keeping*, there are always at least two entries; one of these is always a credit, the other is always a *debit*.

Creditor

Someone who is owed money, goods or services.

Cumulative preference shares

Preference shares with the additional condition that, if any *preference dividends* for past years have not been paid, these must be paid in full before a *dividend* can be paid to the *ordinary shareholders*.

Current asset

An *asset* that is expected to be turned into cash within one year of the *balance sheet date*.

Current liability

A *liability* that is expected to be paid within one year of the *balance sheet date*.

Current ratio

Current assets divided by *current liabilities*.

Debenture

A *long-term loan* issued by a company, usually with *security* over some or all of the company's *assets*.

Debit

In *double entry book-keeping*, there are always at least two entries; one of these is always a *credit*, the other is always a *debit*.

Debt

1. Money, goods or services owed.
2. Any funding which has a known rate of *interest* and *term*. Typically, a form of *loan* or *overdraft*.

Debtor

Someone who owes money, goods or services.

Debt to equity ratio (Gearing)

Debt divided by *equity*.

Deferred revenue/income

Cash received as payment for goods or services before those goods or services have been provided. Since the goods or services have not been provided, the revenue cannot yet be *recognised*, i.e. it is *deferred*.

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Deferred shares

Typically, *shares* that have voting rights but no rights to a *dividend* until certain conditions are met (e.g. profits reach a specified level).

Depreciation

The amount by which the *book value* of a *tangible fixed asset* is deemed to have fallen during a particular *accounting period*. Depreciation therefore appears as an *expense* of that period.

Directors' report

Report on a company's affairs by the directors (included as part of the *annual report*).

Distribution

Payment of a *dividend* to *shareholders* (thereby 'distributing' some of the profits of the company).

Dividend

Payment made to *shareholders* out of the *retained profit* of the company.

Double entry book-keeping

Procedure for recording *transactions* whereby at least two entries are made on the *balance sheet*, thereby enabling the balance sheet to remain 'in balance'.

Doubtful debt

Money due to a company which the company is not reasonably confident of receiving.

Earnings before Interest and tax (EBIT)

(Profit before interest and tax, Trading profit, Operating profit)

The profit generated by the *underlying operation* of a company, i.e. profit before taking account of *interest* (either payable or receivable) and *corporation tax*.

Earnings (Profit for the year)

Profit attributable to ordinary *shareholders* (after taking account of *corporation tax*, *minority interests*, *extraordinary items*, *preference dividends* but before taking account of any *ordinary dividends payable*).

Equity method

Method of accounting for *associates* whereby the *investment* is shown on the investor's *balance sheet* as the investor's share of the *net assets* of the associate.

Exceptional item

Any item that is part of the ordinary activities of a company but which, because of its size or nature, needs to be disclosed if the financial statements are to give a true and fair view.

Exchange gain/loss

Gain or loss made as a result solely of the movement in the exchange rate between two currencies.

Expense

Any cost incurred which reduces the profits of a particular *accounting period* (as opposed to *capital expenditure* or *prepayments*, for example).

Extraordinary item

Any expense or income which falls outside the ordinary activities of a company and is not expected to recur. These occur very rarely.

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Final dividend

Dividend declared at the end of a company's *fiscal year*. Has to be approved by the *shareholders*.

Finance lease

A *lease* where the *lessee* (i.e. the user of the *asset*) has the vast majority of the risks and rewards of ownership of the asset, i.e. the lessee effectively owns the asset. For accounting purposes, finance leases are treated as if the lessee had actually bought the asset with a *loan* from the *lessor*.

Financial Reporting Standards (FRS)

The *accounting standards* issued by the *Accounting Standards Board*.

Financial structure (Capital structure, Funding structure)

The relative proportions of the funding for a company that are provided by *debt* and *equity*.

First in First out (FIFO)

Method of accounting for *stock* whereby, if a company has identical items of stock which cost different amounts to buy or produce, the oldest stock is assumed to be used first.

Fixed asset

An *asset* used by a company on a long-term continuing basis (as opposed to assets which are used up in a short period of time or are bought to be sold on to customers).

Fixed cost

An *expense* which does not change with small changes in the volume of goods produced (examples might include rent, rates, insurance etc.).

Floating charge

A *charge* over a certain class of *asset* of a company rather than any specific asset.

Fundamental principle of accounting

The *assets* of a company must always exactly equal the *claims* over those assets.

Funding structure (Capital structure, Financial structure)

The relative proportions of the funding for a company that are provided by *debt* and *equity*.

Gearing (Debt to equity ratio)

General term used to describe the use of *debt* as well as *equity* to fund a company. The term is used more specifically to describe the ratio of debt to equity. N.B. Variants on this definition exist.

Going concern concept

One of the basic accounting concepts: when preparing a *balance sheet*, it is assumed that the company will continue in business for the foreseeable future. Goodwill

The difference between what an investing company pays for *shares* in an *associate* or *subsidiary*, and the *net book value* of the company.

Gross assets

The total *assets* of a company before deducting any *liabilities*.

Gross margin

Gross profit as a percentage of *turnover*.

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Gross profit

Turnover less cost of goods sold.

Historical cost convention

Accounting convention whereby *assets* are recorded in a company's *books* based on the price paid for them (as opposed to the *market value* or replacement cost of those assets at the *balance sheet date*).

Insolvent

A company is insolvent when it is unable to meet its *liabilities*.

Instrument (Security)

General term for any type of *debt* or *equity*.

Intangible asset

A *fixed asset* which cannot be touched (e.g. patents, goodwill, brand names).

Interest

The amount paid to lenders in return for the use of their money for a period of time.

Interest cover

Operating profit divided by *interest payable*.

Interim dividend

Dividend declared in the course of a company's *fiscal year*.

Inventory (Stock)

Raw materials, *work in progress* and finished goods.

Investment

An *asset* that is not used directly in a company's operations.

Invoice

Formal document issued by a supplier company to its customer (recording the details of the *transaction*).

Issued share capital (Allotted share capital)

The amount of the *authorised share capital* that has actually been issued to investors.

Journal entry

End-of-period adjustment to a company's accounts (e.g. to *post accruals* or *depreciation*).

Last In First out (LIFO)

Method of accounting for *stock* whereby, if a company has identical items of stock which cost different amounts to buy or produce, the newest stock is assumed to be used first.

Lease

An agreement whereby the owner of an *asset* (the *lessor*) allows someone else (the *lessee*) to use that asset.

Lessee

The user of an *asset* which is owned by someone else but is being used by the lessee under the terms of a *lease*.

Lessor

The owner of an *asset* which is being used by someone else under the terms of a *lease*.

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Liability

Money, goods or services owed by a company.

Lien (Charge)

First claim over an *asset* (normally taken as *security* for a *loan*).

Limited company

A company whose *shareholders* do not have any *liability* to the company's *creditors* above the amount they have paid into the company as *share capital*. Hence the shareholders have 'limited liability'.

Liquid assets

Assets which are either cash or can be turned into cash quickly and easily.

Liquidate

To sell all a company's *assets*, pay off the *liabilities* and pay any remaining cash to the *shareholders*.

Liquidity

The ability of a company to pay its short-term *liabilities*.

Listed company (Quoted company)

A company whose *shares* can be bought or sold readily through a recognised *stock exchange*.

Loan

Funding of a fixed amount (unlike an *overdraft*, which varies on a day to day basis), with a known rate of *interest*, an agreed repayment schedule and, usually, a *charge* over some or all of the company's *assets*.

Long-term loan (Bond, Loanstock)

A *loan* which is not due to be repaid for at least twelve months.

Long-term liability

Any *liability* which does not have to be settled within the next twelve months.

Marketable

An *asset* is marketable if it can be sold quickly and without affecting the market price of similar assets.

Market capitalisation

The total *market value* of all the *ordinary shares* of a *listed company*.

Market value

The value of an *asset* to an unconnected third party.

Matching

The process under the *accruals concept* whereby all *expenses* incurred to generate the *sales* of an *accounting period* are *recognised* in the accounts of that period.

Member (Shareholder)

Holder of *shares* in a company.

Minority Interest

When a *parent company* owns less than 100% of a *subsidiary*, the *consolidated accounts* will identify separately 'minority interests' to show the portion of the *net assets* and the year's profits which are attributable to the owners of the minority *shareholding* rather than to the shareholders of the parent company.

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Mortgage

A *charge* over a specific *asset*.

Net assets (Net worth)

The total *assets* of a company less its *liabilities*.

Net book value

The value of an *asset* as recorded in the company's *books* after allowing for *accumulated depreciation* or *accumulated amortisation*.

Net operating assets (Capital employed)

The total amount of money tied up in a business in the form of *fixed assets* and *working capital*. It is also equal to the sum of the *equity*, the *debt* and any deferred tax.

Net realisable value

The price which could be obtained if an *asset* were sold (after allowing for all costs associated with the sale). The term is usually applied to valuation of *stock*.

Net worth (Net assets)

The total *assets* of a company less its *liabilities*.

Nominal ledger

A book or computer program which records details of each of the individual nominal accounts.

Nominal value (Par value)

The face value of a company's *shares*. The company cannot issue shares for less than this value.

Off balance sheet finance

Funding raised by a company which does not have to be *recognised* on its *balance sheet*.

Operating cash flow

The change in a company's cash during an *accounting period* due solely to its *underlying operation* (i.e. disregarding interest/tax/ dividend payments, equity/debt issues etc).

Operating expense

Expense incurred by the *underlying operation* (i.e. excluding all *funding structure* items such as *interest*, *tax*, etc.).

Operating lease

A *lease* where the *lessee* does not take on substantially all the risks and rewards of ownership of the *asset*.

Operating profit (Earnings before Interest and tax, Profit before Interest and tax, Trading profit)

The profit generated by the *underlying operation* of a company; i.e. profit before taking account of *interest* (either payable or receivable) and *corporation tax*.

Ordinary dividend

Dividend paid to holders of *ordinary shares*.

Ordinary share

The most common *class* of *share*. Entitles the holder to a proportionate share of *dividends* and *net assets*, and to vote at meetings of the *shareholders*.

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Overdraft

Funding provided by a bank. Unlike a loan, the amount varies on a day to day basis, and is usually repayable on demand. An overdraft carries a known rate of *interest*, and usually the company will have to give the bank a *charge* over some or all of its *assets*.

Overdraft facility

Agreed limit of an *overdraft*.

Overheads

Operating expenses which cannot be directly ascribed to the production of goods or services.

Parent company

A company which has one or more *subsidiaries*.

Participating preference share

A *preference share* whose *dividend* is increased if the company meets certain performance criteria.

Par value (Nominal value)

The face value of a company's *shares*. The company cannot issue shares for less than this value.

Payout ratio

Dividends divided by *profit for the year*.

Petty cash

Small amounts of cash held on a company's premises to cover incidental expenses.

Post balance sheet event

An event which takes place after the *balance sheet date* but which needs to be disclosed in order that the *annual report* should give a true and fair view of the company's financial position.

Posting

Making an entry onto a company's *books*.

Preference dividend

Dividend payable on a *preference share*.

Preference share

Share which has a right to a *dividend* which must be paid in full before the *ordinary shareholders* can be paid a dividend.

Prepayment

A payment made in advance of the receipt of goods or services (e.g. a deposit).

Price earnings ratio (P/E)

Share price divided by *earnings per share*. Equal to *market capitalisation* divided by *earnings*.

Prior year adjustment

An adjustment to a prior year's *accounts*.

Profit & loss account

A statement showing how the *retained profit* of a company (as shown on the *balance sheet*) changed during a particular *accounting period*.

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Profit after tax

Profit after taking account of all *expenses* including *interest* and *corporation tax* (but before taking account of any *dividends payable*).

Profit before interest and tax (PBIT) (Earnings before Interest and tax, Operating profit, Trading profit)

The profit generated by the *underlying operation* of a company, i.e. profit before taking account of *interest* (either payable or receivable) and *corporation tax*.

Profit before tax (PBT)

Profit after all *expenses* including *interest* but before *corporation tax*.

Profit for the year (Earnings)

Profit attributable to *ordinary shareholders* (after taking account of *corporation tax*, *minority interests*, *extraordinary items*, *preference dividends* but before taking account of any *ordinary dividends payable*).

Profitability

The amount of profit made by a company for each pound of capital invested. Usually measured as *return on capital employed* and/or *return on equity*.

Provision

An *expense recognised* in the accounts for a particular *accounting period* to allow for expected losses (e.g. a *doubtful debt*).

Prudence concept

One of the basic concepts of accounting: *revenues* are only included when the cash due from the customers is reasonably certain; *accruals* and *provisions* are made for all likely *expenses* and losses.

Public limited company (plc)

A *limited company* which is subject to more stringent legal requirements than a *private limited company*. All listed companies are plc's but a plc need not be listed.

Purchase ledger

A book or computer program in which details of suppliers and amounts owed to them are recorded.

Qualified auditors' report

An *auditors' report* which has a qualification to the usual 'true and fair view' statement.

Quick ratio

Current assets less stock divided by *current liabilities*.

Realisation

Conversion of an *asset* into cash, or a promise of cash which is reasonably certain of being fulfilled.

Recognition

The inclusion of the impact of a *transaction* on a company's *balance sheet* and/or *profit and loss account*.

Redeemable preference share

Preference share which has a fixed *term*, at the end of which the holder's money is returned and the preference share cancelled.

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Reserve

A part of *equity*, other than *share capital*, which represents a claim of the *shareholders* of a company over some of the *assets* of the company. Examples include *retained profit* and *revaluation reserve*.

Retained profit/earnings

The total cumulative profits of a company that have been retained (i.e. not *distributed* to *shareholders* as *dividends*).

Revaluation reserve

A *reserve* created when the *net assets* of a company are increased due to the revaluation of certain of the company's *assets*.

Revenue

The amount due to (or paid to) a company in return for the goods or services supplied by that company. Note that revenue is usually recorded in a company's accounts net of VAT (i.e. after subtracting the VAT element).

Rights issue

An issue of new *shares* whereby the *shareholders* have the right to acquire the new shares in proportion to their existing holdings before the shares can be offered to anyone else.

Sales (Turnover)

The total *revenues* of a company in an *accounting period*.

Sales ledger

A book or computer program in which details of customers and amounts owed by them are recorded.

Scrip issue

A free issue of additional *shares* to *shareholders* in proportion to their existing holdings. It has no effect on the *market capitalisation* of a company but reduces the price of each share.

Security

1. Rights over certain *assets* of a company given when a *loan* or *overdraft* are granted to the company. If the terms of the loan or overdraft are breached then the rights can normally be exercised to enable the lenders to get their money back.
2. **(Instrument)** A general term for any type of *equity* or *debt*.

Share

One of the equal parts into which any particular *class* of a company's *share capital* is divided. Each share entitles its owner to a proportion of the *assets* due to that class of share capital.

Share capital

The *nominal value* of the *shares* issued by a company. 'Share capital' is also used more generally to describe any funding raised by a company in return for *shares*.

Shareholder (Member)

Holder of *shares* in a company.

Shareholders' equity/funds (Equity, Capital and reserves)

The share of a company's *assets* that are 'due' to the *shareholders*. Consists of *share capital*, *share premium*, *retained profit*, and any other *reserves*.

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Share premium

The amount paid for a company's *shares* over and above the *nominal value* of those shares.

Share price

The *market value* of each *share* in a company.

Short-term loan

A *loan* which is due to be repaid within twelve months of the *balance sheet date*.

Statement of standard accounting practice (SSAP)

The *accounting standards* set by the *Accounting Standards Committee (ASC)*. The ASC has now been replaced by the *Accounting Standards Board (ASB)*, whose new standards are known as *Financial Reporting Standards*. The SSAPs remain in force, however, until withdrawn by the ASB.

Stock

1. Raw materials, *work in progress* and goods ready for sale.
2. In USA, the equivalent of *shares*.

Stock exchange

A market on which a company's *shares* can be *listed* (and therefore be readily bought and sold).

Subsidiary undertaking (subsidiary)

Broadly speaking, a company is a subsidiary of another company (the *parent company*) if the parent company owns more than 50% of the voting rights or exerts a dominant influence over the subsidiary.

Tangible fixed asset

A *fixed asset* that can be touched, such as property, plant, equipment.

Taxable Income

The income on which the Inland Revenue calculates the *corporation tax* payable by a company.

Term

Duration of a *loan*, *redeemable preference share* or other *instrument*. Trade creditors (Accounts payable)
The amount a company owes its suppliers at any given moment.

Trade debtors (Accounts receivable)

The amount a company is owed by its customers at any given moment.

Trade investment

A long-term investment made by one company in another for strategic, trading reasons.

Trading profit (Operating profit, Profit before interest and tax, Earnings before interest and tax)

The profit generated by the underlying operation of a company; i.e. profit before taking account of interest (either payable or receivable) and corporation tax.

Transaction

Anything a company does which affects its financial position (and therefore its *balance sheet*).

Trend analysis

Method of assessing a company by analysing the trends in its performance measures over a period of time.

Glossary of accounting terms

Trial balance (TB)

A list of all the *nominal ledger accounts*, showing the balance in each. It is, in effect, a very detailed *balance sheet*.

Turnover (Sales)

The total *revenues* of a company in an *accounting period*.

Underlying operation

The actual business of a company, i.e. the elements of the company which are unaffected by the *funding structure* (the way in which the funding for the company was raised).

Value added

The difference between a company's *outputs* and *inputs*.

Variable cost

An *expense* which changes even with small changes in volume (e.g. *raw materials costs*).

Weighted average method

Method of accounting for *stock* whereby, if a company has identical items of stock which cost different amounts to buy or produce, the average value is used.

Work in progress

Goods due for sale but still in the course of production at the *balance sheet date*.

Working capital

The amount of additional funding required by a company to operate its *fixed assets*, e.g. money to pay staff and bills while waiting for customers to pay. Working capital is equal to *capital employed* less *fixed assets*.

Wind up

Cease trading and *liquidate* a company.

Write up/down/off

Revalue an *asset* (upwards, downwards or down to zero).



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