GLOSSARY OF BUSINESS FINANCE TERMINOLOGY
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Introduction

Finance and accounting terminology can be complicated and confusing, especially if you have just started your business or are dealing with this type of language for the first time.

This glossary explains some of the key terms that are regularly used when running a business, especially when you are dealing with finance professionals such as accountants. It will prove particularly useful if you are looking through business accounts or preparing financial information for your own business.

Glossary

Accounting code: Numbers or letters assigned to budget or cost centres within an organisation to simplify allocation of income, expenditure and balance sheet headings.

Accounting period: The regular period (normally a year) for which a business accounts for its income, expenditure, assets and liabilities.

Accounts: The financial records of a business. These show an analysis of the profit and loss account and the balance sheet.

Accounts payable: Money that a business owes to suppliers for products and services purchased on credit (also known as creditors).

Accruals: A term used in accounts to describe income that is due, or costs that are incurred, during an accounting period but not received or paid during that accounting period.

Acid test ratio: The current assets of a business, minus stocks and divided by current liabilities. The ratio shows whether a business would be able to pay its debts (if it needed to pay creditors) with no time to sell any of its assets. The business passes the test if the result is one or higher, though for most businesses an acid test of greater than 0.7 is adequate.

Added value: This is the value of improvement made to goods or services at any particular stage in their production.

Administration: The process by which a company in severe financial difficulty applies to the high court for protection from its creditors. The court appoints an administrator to take over the management of the company while a restructuring plan is implemented. The process can last for up to a year and may save the company from being forced into liquidation.

Amortisation: An annual charge made in a business' profit and loss account to reduce the value of an intangible asset as shown in the business balance sheet.

Annual Percentage Rate (APR): Where interest on loans is expressed as something other than a yearly rate (1.5% per month, for example), APR is the equivalent rate over a year.

Appropriation account: The part of the profit and loss account that shows how the profit has been divided (or appropriated) into dividends and reserves.

Assets: A business' goods, resources and property that have a monetary value.

Audit: An examination and verification of a business' financial and accounting records and supporting documents by a professional accountant. A legal requirement for limited companies over a certain size or turnover, audits must be undertaken and signed by an accountant who is a registered auditor.

Authorised capital: The maximum share capital a company is allowed to issue under its memorandum of association. An increase in authorised capital can only take place in accordance with procedures laid down in the Companies Act 2006.

Bad debts: Debts owed to a business that are unlikely to be received and should be written off.

Balance sheet: A statement providing a snapshot of everything a business owes and owns at a particular moment in time.

Bankruptcy: A situation where an individual is incapable of settling their debts and has been served with a bankruptcy order by a court.

Base rate: The rate of interest, set by the Bank of England, on which financial institutions base their lending rates. Their lending rates will be a certain percentage above the base rate, and their savings rates below. When the base rate changes, this generally affects all their other rates (though it is sometimes possible to negotiate fixed rates on loans).

Bookkeeping: Recording the financial transactions of a business in its books and keeping those accounts in order, either for a review or an external inspection.

Book value: Value of an asset as shown in the accounting records. Book value usually means original value less accumulated depreciation, though in the case of premises it may mean the latest valuation.

Books: A business' financial records; for example, its cash book, sales ledger, purchase ledger and payroll.

Break-even point: Point at which income from sales exactly equals the total costs for the business.

Budget: A plan for the allocation and use of resources, often involving the production of an itemised list of expected income and expenditure for a given future period.

Business angel: A private equity investor, usually with a business background, who is able to make a small-scale equity investment in a young business to help it grow. Business angels sometimes also supply hands-on expertise to assist in the running of the business.

Business plan: A document detailing the future direction of a business, setting out its objectives and how they are to be achieved.

Capital: Money brought into a business by way of share capital and loan capital, as well as retained earnings.

Capital employed: Capital introduced plus retained profit plus long-term loans. Some definitions exclude long-term loans while others include short-term loans. Capital employed is equal to the net worth of a business.

Capital Gains Tax: A tax payable by individuals based on the chargeable gains made from selling or disposing of assets. This is likely to be an important consideration when selling shares or a business.

Cash: Money in hand or in a bank account.

Cash book: A record of all cash receipts and payments.

Cash flow: The money coming into and going out of a business in a given period. Cash flow may be positive (if more comes in than goes out) or negative.

Cash flow forecast: A projection of what a business expects its cash income and cash payments to be in a given period of time. Business plans should include a cash flow forecast to indicate how much working capital needs to be made available if negative cash flow is expected at any stage.

Collateral: An asset pledged as a guarantee to a lender until a loan is repaid. If the borrower defaults on their loan payments, the lender has a right to sell the collateral asset to recover their loan.

Company voluntary arrangement: A legally binding agreement between a company and its creditors, which allows the company to repay part of the debt that it owes each creditor, while it continues to trade.

Consolidated accounts: The accounts of a parent company or holding company, which combine the accounts of all subsidiary companies.

Consumer credit: Provision of credit to retail customers. An example is hire purchase or deferred payment. Businesses providing consumer credit must comply with the Consumer Credit Act 1974 (as amended).

Contingent liability: Liabilities that may be incurred by a business which depend on the outcome of a forthcoming event, such as a court case, which may or may not happen. This should be recorded in the notes to the accounts.

Contribution: The difference between the price charged and the direct costs involved in making a product. This 'contributes' to covering the fixed costs or overheads and, once all the fixed costs are covered, contributes to the net profit.

Corporation tax: The tax on a company's trading profits, charged as a percentage of the profits made during its accounting period.

Cost of sales (also known as direct costs): The cost to a business of producing goods. In the case of a retail or distribution business, cost of sales is the cost of purchasing goods prior to their resale.

Credit: In banking terms, credit is either a receipt that is paid into a bank account or a facility that allows a business to borrow money. In bookkeeping terms, a credit is an accounting entry, which results in an increase in the business' liabilities or a decrease in its assets.

Credit limit: A limit on borrowing from a bank, or a limit that a business imposes on how much its own customers can purchase on account.

Credit note: A note, issued to a person or business when goods are returned by them, which cancels or modifies the original invoice.

Credit period: The time allowed between the provision of goods or services and when they have to be paid for.

Creditors: People or businesses who are owed money. Suppliers who are owed money are described as 'trade creditors' to differentiate them from other creditors, such as banks. They are usually shown separately on the balance sheet.

Creditors' turnover ratio: A measure of how quickly a business pays its creditors. For suppliers this is calculated as total purchases divided by the average value owed to trade creditors (excluding VAT) in the year. Dividing 365 by the result gives the number of days that it takes for the business to pay its creditors, which is known as the average payment period.

Current assets: Assets in a cash or near cash state, such as debtors and stock.

Current liabilities: Debts owed by a business which have to be paid back in less than 12 months.

Current ratio: A financial ratio that measures the ratio of current assets to current liabilities. The ratio indicates whether a business has sufficient working capital to operate.

Debenture loan: A type of long-term loan taken out by a business, which it agrees to repay at a specified future date. The business will usually pay a fixed rate of interest to debenture holders each year until maturity. If it fails to pay either the interest or the principal amount of the loan when the time comes, the debenture holders can force the business into liquidation and recover their money from a sale of the assets.

Debit: In banking terms, debit is a payment made from a bank account. In bookkeeping terms a debit is an accounting entry, which results in an increase in a business' assets or a decrease in its liabilities.

Debt: Money that is owed to a person or business.

Debtors: Businesses or individuals who owe a business money, usually resulting from the purchase of goods or services.

Debtors' turnover ratio: A measure of how quickly debtors pay their debts. This is calculated as total sales divided by the average value of debtors (excluding VAT) in the year. Dividing 365 by the result gives the number of days that it takes for a debtor to pay the business, which is known as the average collection period.

Depreciation: The charge in a business' accounts that reflects the reduction in value of a tangible asset over time, as its useable life is exhausted (see Amortisation). Depreciation is charged before calculation of profit, on the grounds that the use of capital assets is one of the costs of being in business and one of the contributors to profit.

Direct costs: Sometimes known as cost of sales, these are the costs that can be directly attributed to the production of a particular product or service (for example, raw materials and direct labour).

Disbursement: Money paid out for incidental expenses.

Discount: A deduction from the recommended price of an item, or a bonus for prompt payment.

Discounted cash flow: Technique for comparing projects to see which may give the best return on investment. It is used when comparing two projects that will generate income at different times, as it makes allowance for the fact that money now is worth more than money in the future.

Dividend: Payment made from net profits to the shareholders of a company.

Double entry: The method of bookkeeping where every transaction is entered as a debit to one account and a credit to another account. The totals of debits and credits are always equal.

Drawings: Money that self-employed people withdraw from their businesses to cover their monthly living costs. Drawings are regarded as an advance against the profits of a business, not as a business expense. This is unlike a salary paid to an employee, which is allowable as a company expense (although the salary attracts tax and National Insurance (NI) under the Pay as you Earn (PAYE) scheme).

Equity: The capital which shareholders own in a company.

Euro: Name of the single currency of the European Union (EU), introduced on 1 January 1999 but not in use in all European countries.

Expenses: General term which can mean all the costs of a business, but is normally used to signify overhead expenses (as opposed to direct costs).

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Factoring: Specialised companies (factors) which will pay a business a proportion of the amount it is owed, in return for the right to collect debts from customers. The factors charge the business fees and interest.

Finance house: A company whose business is lending money. It also accepts deposits from savers.

Financial services: Term covering areas like banking, building societies, insurance, loans and pensions.

Financial Services Authority (FSA): Government body undertaking regulatory responsibilities for the UK financial services industry.

Financial year: The 12-month period which a business chooses for its accounting year.

Finished goods: Stocks of goods that are ready to sell.

Fixed assets: Assets with a life of longer than one year (such as buildings and machinery).

Fixed charge: A form of security taken by a lender over a specified asset, which cannot then be sold without the charge being released.

Fixed costs: Costs which are fixed for a business for a reasonable length of time, and not dependent on the number of units produced (such as rent, rates and salaries).

Fixed rate: A loan in which the interest rate does not change during the entire term of the loan.

Floating charge: A form of security taken by a lender (typically the bank) over all the assets of the business. Assets can be used and sold in the normal course of the business (i.e. stock items), until the business is in default of its lending agreement, whereupon the lender has the right to claim the assets.

Flotation: Term used to describe the entry of a company to the stock market.

Gearing: A measure of debt as a proportion of total finance. It is usually expressed as the ratio of debt to capital employed.

Goodwill: The value of a business to a purchaser over and above its net asset value. It reflects the value of intangible assets like reputation, brand name, good customer relations, high employee morale and other factors that improve the firm's performance.

Grants: Financial assistance given to a business by a third party (such as the Government). Grants do not usually have to be repaid provided agreed terms are met.

Gross profit: The difference between turnover and the cost of making a product or providing a service, before taking into account overheads, indirect salaries and interest payments.

Gross profit margin: Gross profit divided by sales, usually expressed as a percentage.

Guarantor: A person who commits to guarantee the debts of another. If, for example, an individual fails to meet their obligations on hire purchase repayments, the guarantor will be obliged to make those repayments.

Hire purchase: An agreement to hire goods for a period of time, with the option of purchasing them at the end of the agreement for a reduced sum.

HM Revenue & Customs (HMRC): Government department responsible for the collection of tax and customs duties. This includes income, corporation, capital gains, inheritance and environmental taxes; and value added tax (VAT), National Insurance (NI) and excise duties.

Income tax: Tax on an individual's income.

Indirect costs: Business costs that cannot be attributed directly to the production of a particular product or service (such as bank charges or rent).

Inflation: The overall general increase in the price of goods and services in an economy. Traditionally it has been measured by the Retail Price Index (RPI) which is a domestic measure of inflation in the UK. The measure of inflation for macroeconomic purposes and for the Government's current inflation target now comes from the Consumer Prices Index (CPI) which is known internationally as the Harmonised Index of Consumer Prices (HICP).

Inheritance tax: Tax payable by the new owner (or the transferor) on assets transferred upon the death of the previous owner over a certain threshold.

Input tax: The VAT that a business pays on supplies (inputs) required for it to produce goods or services.

Insolvency: The situation in which a person or business is unable to meet debts when they fall due.

Intangible assets: Assets that are non-physical in form. Examples include patents, goodwill, trade marks and copyrights.

Interest: The amount charged by a lender on borrowed money, usually expressed as an annual percentage.

Interest cover: Measure of the ease with which a business can meet its interest payments out of profit. It is calculated as profit before interest and tax (PBIT) divided by interest paid.

Inventory: Stock items or a list detailing them. In accounting, inventory is the sum of raw materials, components, work in progress and finished goods still not sold.

Investment: Using money (to buy assets, for example) in the hope of receiving income or a larger repayment in return.

Investment appraisal: Evaluation of any investments or potential investments to be made, usually in profit terms.

Invoice: A bill issued for products or services provided to a customer.

Invoice discounting: A commercial arrangement in which a third party (the discounter) pays an advance on the value of an invoice which is not yet due for payment. Interest and fees are charged by the discounter for this service.

Lease: A contract in which the legal owner of property or another asset agrees to allow another person to use that property or asset in return for a regular specified payment (known as rent) over a set term. In addition to buildings, other items such as cars and computers are often leased in order to avoid capital costs in the running of a business.

Lease purchase: A variation on leasing. At the end of the lease period the goods become the lessee's property.

Leverage: The ratio of total finance to equity. This term is more commonly used in the US - in the UK the popular term is gearing.

Liabilities: Combined debts owed by a business, whether short or long-term.

Liquid assets: Cash or items such as debtors and finished stock that can readily be converted into cash.

Liquidation: Formal closing down of a company. Any assets are sold and used to pay off some or all of the firm's debts.

Liquidity: Measure of the working capital or cash available to a business to enable it to meet its liabilities as they fall due. Liquidity ratios include the current ratio and the quick ratio (also known as the 'acid test').

Loss: Where expenditure exceeds income in a given period.

Management accounts: Detailed financial accounts normally prepared monthly for internal use by a business.

Management buy-in: The purchase of a business by outside investors who bring with them a new set of managers.

Management buy-out: Purchase of all or part of a business by its existing managers, often with the backing of venture capitalists.

Margin of safety: Describes how far above break-even point a business is operating.

Marginal costing: The amount spent on producing one extra unit. The marginal cost is the increase in total cost when one more unit is produced. Marginal costing compares the marginal revenue (the extra income) of selling the extra unit with the marginal cost.

Mark-up: The profit margin on goods or services, expressed as a percentage of the product's cost.

Maturity: The date on which a debt becomes due for payment.

National Insurance (NI): NI is a contribution towards state benefits, such as pensions, unemployment and incapacity benefits. Contributions are paid by everyone who works, whether as an employee or on a self-employed basis, and by all employers.

Negative cash flow: Where more money is going out of a business than is coming in.

Net current assets: Current assets minus current liabilities. This should normally be positive, otherwise a business may not be able to meet its debts as they fall due.

Net present value: The value of a business' future trading, expressed in today's money. In the discounted cash flow method of evaluation, the comparison between two commercial projects is based on their net present value.

Net profit: The gross profit of a business less all expenses. In business accounts, the word 'net' is often dropped, so that you simply have 'Profit before tax' and 'Profit after tax'.

Net profit margin: Measures trading profit relative to sales revenue. It is calculated by net profit divided by sales and expressed as a percentage.

Net worth: Total assets less total liabilities.

Operating profit: Actual profit made by a business after the deduction of all expenses except interest. For self-employed people, drawings are not regarded as an expense; however, salaries and wages for company directors and staff are allowable as expenses.

Output tax: The amount of VAT a business adds to the price of its product or service.

Overdraft: A flexible form of bank lending on a current account, allowing the customer to overdraw money to a certain limit. Banks may agree an overdraft limit (the maximum amount they will allow the customer to overdraw by) but will charge interest and may require additional fees. An overdraft is often used as a short-term business finance facility, but it can be cancelled by the bank at any time.

Overheads: All operating costs that are not directly linked to a product and which, generally speaking, are fixed costs (such as rent, utilities and insurance).

Overtrading: When a business is selling more products or services than the working capital facilities can cope with, which is often the result of poor planning.

PAYE (Pay As You Earn): Income tax on salaries and wages. All employers are required to deduct income tax from employees' pay. The system uses tax codes to adjust the level of deductions from each employee's wages.

Payroll: The financial record of employees' salaries, wages, bonuses, net pay and deductions.

Personal expenses: Expenses incurred by an individual while on business, and normally reclaimable as business expenses.

Petty cash: A small amount of cash kept on hand by a business for incidental expenses.

Positive cash flow: The situation in which more money is coming into a business than is going out of it.

Pricing: Goods and services can be priced by taking the cost of making or providing them and adding a mark-up for profit. Some businesses add a fixed percentage.

Profit: Level by which income exceeds expenditure in a given period.

Profit and loss account: A set of accounts, usually prepared annually or monthly, which depict a business' trading performance. This is normally read in conjunction with the balance sheet and cash flow statement.

Profit margin: Ratio of profit to sales; calculated using either gross profit (gross profit margin) or profit before interest and tax (net profit margin). Often expressed as a percentage (100 x profit divided by sales). It shows how profitable a business is.

Purchase ledger: Used to record all suppliers' invoices and payments to suppliers, and to show which invoices remain unpaid.

Qualified accounts: Audited company accounts where the auditor has expressed doubts or disagreement over the information shown in the accounts.

Quick ratio: A financial ratio that measures how readily a firm can pay off its debts. It is the ratio of cash plus debtors to current liabilities, and is also called the 'acid test ratio'.

Ratio analysis: This is a tool for analysing the financial performance of a business by calculating ratios from its accounts. These ratios can help to give a more in-depth picture of how the business is managing the resources it has. Four main types of ratio look at liquidity, solvency, efficiency and profitability.

Raw materials stock: Stocks of materials required to manufacture products, held by the manufacturer for future use.

Reducing balance depreciation: Where depreciation on a fixed asset is calculated by applying the depreciation rate to the net book value.

Reserves: The retained profits of a business that form part of its capital.

Return on investment: Amount of money generated by a capital investment in a given period of time expressed as a percentage of the total amount invested.

Revenue: Income generated by a business for a specific period.

Salary: The gross amount of money paid to an employee in return for their labour. It is usually paid monthly (unlike wages, which are usually paid weekly) and expressed as an annual sum. It is subject to PAYE and NI deductions by the employer, and the employer is also liable for additional NI contributions based on the employee's salary.

Sales ledger: Record of every invoice issued, the amount of cash received and the amount owed to a business by its customers.

Security: An asset that is offered by a borrower to a lender to safeguard a loan.

Self-assessment for tax: The Government has made many individuals responsible for completing their own tax return (online or on paper) and reporting the details annually to HMRC.

Shareholders: Owners of a company's shares or stocks.

Shares: The ownership of a company is divided into shares, each representing a part of the equity capital invested in the business.

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Soft loan: Loan made at an interest rate below the market rate or with lenient repayment terms.

Solvency: Measure of a business' ability to pay its bills as they fall due. If it cannot pay, then it is insolvent. A negative net worth indicates that a business is insolvent.

Staged payments: Payment by instalments. This may be a normal condition in a contract or arranged as a way of improving cash flow where a customer cannot pay the full amount due in one payment. Total charge can be subject to the addition of interest.

Start up costs: Costs specifically associated with setting up in business.

Stock: An asset of a firm held for sale in the ordinary course of business. Raw materials, components and consumables may also be held in stock. You should remember to write off 'dead stock' periodically so as not to be lulled into false sense of security by this figure.

Stock exchange: A financial centre where shares in public companies are traded.

Straight line depreciation: Method of accounting for the depreciation of a fixed asset across its estimated useful life in equal instalments.

Tangible assets: Physical assets owned by a business or individual that can be seen or touched, such as stock and machinery.

Tax avoidance: Reducing or deferring the amount of tax that needs to be paid by making best use of available allowances and claiming for all allowable expenses.

Tax evasion: Illegal attempts to pay less tax than required (for example, by forging expenses or hiding income).

Taxable supplies: Goods and services supplied to a customer that are liable for VAT (even if zero rated).

Taxable turnover: The total value of taxable sales for VAT purposes.

Trade Credit: When businesses trade, a supplier may extend credit terms to a customer, which allows the customer to buy goods or services up to a certain value (the credit limit) and then pay for the items in accordance with the agreed credit terms. Typically this may mean payment is made between 30 to 60 days after the goods have been purchased.

Trial balance: In double entry bookkeeping, checking to see if all debit and credit items in a ledger have the same total.

Turnover: Total sales income. Net turnover is calculated by total sales income less returns. VAT is not included in turnover figures.

Unsecured loan: A loan under which the lender has no entitlement to any of the borrower's assets in the event of the borrower failing to make the loan repayments. Such a loan normally carries a higher interest rate than a secured loan.

Value Added Tax (VAT): VAT is a tax on consumer expenditure, and is collected on business transactions. The VAT that businesses pay to HMRC is equal to their output tax minus their input tax.

Variable costs: Costs that vary with production levels (for example, direct costs such as raw materials). In some businesses, however, costs such as power consumption may also vary substantially depending on output; these would then be regarded as variable.

VAT registration: Businesses whose annual turnover exceeds a certain threshold must register with HMRC to become a VAT vendor. Businesses with a lower turnover than the threshold can still register voluntarily.

Venture capital: Funding which may be made available to companies with good prospects of growth who are unable to get funds from standard lenders such as banks. Venture capitalists (VCs) supply capital to companies in return for an equity stake in the company.

Wages: Regular money payments to an employee in return for their labour. They are usually paid weekly and based upon an hourly wage rate. Wages are also subject to PAYE and NI deductions.

Wages book: Records wages and salary payments made to employees, as well as PAYE and NI deductions, commonly known as the payroll.

Winding up: Voluntary or compulsory liquidation of a company.

Work in progress: Raw materials, components and products that are within the production process but are not yet finished goods.

Working capital: The difference between current assets and current liabilities. This capital is used to run the business.

Write off: To reduce the value of an asset in the books to zero (for example, to record a debt as being a bad debt).

Written down value: When the book value of an asset is reduced to take depreciation into account, the new value is the written down value or net book value.

Zero-based forecasting: Forecasting that starts from a zero base rather than from the previous year's actual performance figures.

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