Financial accounting terms defined

The definition of one word or phrase may depend on understanding another word or phrase defined elsewhere in the reference list. Words in **bold** indicate that such a definition is available.

**account payable** an amount due for payment to a supplier of goods or services, also described as a **trade creditor**.

**account receivable** an amount due from a customer, also described as a **trade debtor**.

**accountancy firm** A business partnership (or possibly a limited company) in which the partners are qualified accountants. The firm undertakes work for clients in respect of audit, accounts preparation, tax and similar activities.

**accountancy profession** The collective body of persons qualified in accounting, and working in accounting-related areas. Usually they are members of a professional body, membership of which is attained by passing examinations.

**accounting** The process of identifying, measuring and communicating financial information about an entity to permit informed judgements and decisions by users of the information.

**accounting equation** The relationship between assets, liabilities and ownership interest.

**accounting period** Time period for which financial statements are prepared (e.g. month, quarter, year).

**accounting policies** Accounting methods which have been judged by business enterprises to be most appropriate to their circumstances and adopted by them for the purpose of preparing their financial statements.

**accounting standards** Definitive statements of best practice issued by a body having suitable authority.

**Accounting Standards Board** The authority in the UK which issues definitive statements of best accounting practice.

**accruals basis** The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate (see also **matching**).

**accumulated depreciation** Total **depreciation** of a non-current (fixed) asset, deducted from original cost to give **net book value**.

**acid test** The ratio of liquid assets to current liabilities.

**acquiree** Company that becomes controlled by another.

**acquirer** Company that obtains control of another.

**acquisition** An acquisition takes place where one company – the **acquirer** – acquires control of another – the **acquiree** – usually through purchase of shares.

**acquisition method** Production of **consolidated financial statements** for an **acquisition**.

**administrative expenses** Costs of managing and running a business.

**agency** A relationship between a principal and an agent. In the case of a limited liability company, the shareholder is the principal and the director is the agent.

**agency theory** A theoretical model, developed by academics, to explain how the relationship between a principal and an agent may have economic consequences.

**aggregate depreciation** See **accumulated depreciation**.

**allocate** To assign a whole item of cost, or of revenue, to a simple cost centre, account or time period.

**allocated, allocation** See **allocate**.

**amortisation** Process similar to **depreciation**, usually applied to intangible fixed assets.

**annual report** A document produced each year by limited liability companies containing the accounting information required by law. Larger companies also provide information and pictures of the activities of the company.

**articles of association** Document setting out the relative rights of shareholders in a limited liability company.
articulation  The term ‘articulation’ is used to refer to the impact of transactions on the balance sheet and profit and loss account through application of the accounting equation.

assets  Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.

associated company  One company exercises significant influence over another, falling short of complete control.

audit  An audit is the independent examination of, and expression of opinion on, financial statements of an entity.

audit manager  An employee of an accountancy firm, usually holding an accountancy qualification, given a significant level of responsibility in carrying out an audit assignment and responsible to the partner in charge of the audit.

bad debt  It is known that a credit customer (debtor) is unable to pay the amount due.

balance sheet  A statement of the financial position of an entity showing assets, liabilities and ownership interest.

bank facility  An arrangement with a bank to borrow money as required up to an agreed limit.

bond  The name sometimes given to loan finance (more commonly in the USA).

broker (stockbroker)  Member of a stock exchange who arranges purchase and sale of shares and may also provide an information service giving buy/sell/hold recommendations.

broker's report  Bulletin written by a stockbroking firm for circulation to its clients, providing analysis and guidance on companies as potential investments.

business combination  A transaction in which one company acquires control of another.

business cycle  Period (usually 12 months) during which the peaks and troughs of activity of a business form a pattern which is repeated on a regular basis.

business entity  A business which exists independently of its owners.

called up (share capital)  The company has called upon the shareholders who first bought the shares, to make their payment in full.

capital  An amount of finance provided to enable a business to acquire assets and sustain its operations.

capital expenditure  Spending on non-current (fixed) assets of a business.

capitalisation issue  Issue of shares to existing shareholders in proportion to shares already held. Raises no new finance but changes the mix of share capital and reserves.

cash  Cash on hand (such as money held in a cash box or a safe) and deposits in a bank that may be withdrawn on demand.

cash equivalents  Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

cash flow projections  Statements of cash expected to flow into the business and cash expected to flow out over a particular period.

cash flow statement  Provides information about changes in financial position.

chairman  The person who chairs the meetings of the board of directors of a company (preferably not the chief executive).

charge  In relation to interest or taxes, describes the reduction in ownership interest reported in the income statement (profit and loss account) due to the cost of interest and tax payable.

chief executive  The director in charge of the day-to-day running of a company.

close season  Period during which those who are ‘insiders’ to a listed company should not buy or sell shares.

commercial paper  A method of borrowing money from commercial institutions such as banks.

Companies Act  The Companies Act 1985 as modified by the Companies Act 1989. Legislation to control the activities of limited liability companies.

comparability  Qualitative characteristic expected in financial statements, comparable within company and between companies.

completeness  Qualitative characteristic expected in financial statements.

conceptual framework  A statement of principles providing generally accepted guidance for the development of new reporting practices and for challenging and evaluating the existing practices.

conservatism  See prudence. Sometimes used with a stronger meaning of understating assets and overstating liabilities.

consistency  The measurement and display of similar transactions and other events is carried out in a consistent way throughout an entity within each accounting period and from one period to the next, and also in a consistent way by different entities.

consolidated financial statements  Present financial information about the group as a single reporting entity.

consolidation  Consolidation is a process that aggregates the total assets, liabilities and results of the parent and its subsidiaries (the group) in the consolidated financial statements.
contingent liabilities  Obligations that are not
recognised in the balance sheet because they depend
upon some future event happening.
control  The power to govern the financial and
operating policies of an entity so as to obtain benefits
from its activities.
convertible loan  Loan finance for a business that is
later converted into share capital.
corporate governance  The system by which
companies are directed and controlled. Boards of
directors are responsible for the governance of their
companies.
corporate recovery department  Part of an
accountancy firm which specialises in assisting
companies to recover from financial problems.
corporate social responsibility  Companies integrate
social and environmental concerns in their business
operations and in their interactions with stakeholders.
corporation tax  Tax payable by companies, based on
the taxable profits of the period.
cost  of a non-current asset is the cost of making
it ready for use, cost of finished goods is cost of
bringing them to the present condition and location.
cost of goods sold  Materials, labour and other costs
directly related to the goods or services provided.
cost of sales  See cost of goods sold.
coupon  Rate of interest payable on a loan.
credit (bookkeeping system)  Entries in the credit
column of a ledger account represent increases in
liabilities, increases in ownership interest, revenue,
or decreases in assets.
credit (terms of business)  The supplier agrees to allow
the customer to make payment some time after the
delivery of the goods or services. Typical trade credit
periods range from 30 to 60 days but each agreement
is different.
credit note  A document sent to a customer of a
business cancelling the customer’s debt to the
business, usually because the customer has returned
defective goods or has received inadequate service.
credit purchase  A business entity takes delivery of
goods or services and is allowed to make payment at a
later date.
credit sale  A business entity sells goods or services and
allows the customer to make payment at a later date.
creditor  A person or organisation to whom money is
owed by the entity.
critical event  The point in the business cycle at which
revenue may be recognised.
current asset  An asset that is expected to be
converted into cash within the trading cycle.
current liability  A liability which satisfies any of the
following criteria: (a) it is expected to be settled in the
entity’s normal operating cycle; (b) it is held primarily
for the purpose of being traded; (c) it is due to be
settled within 12 months after the balance sheet date.
current value  A method of valuing assets and
liabilities which takes account of changing prices,
as an alternative to historical cost.
customers’ collection period  Average number of
days credit taken by customers.
cut-off procedures  Procedures applied to the
accounting records at the end of an accounting period
to ensure that all transactions for the period are
recorded and any transactions not relevant to the
period are excluded.
de benture  A written acknowledgement of a debt – a
name used for loan financing taken up by a company.
debtor  A person or organisation that owes money to
the entity.
department  A loan issued at a relatively low
price compared to its nominal value.
default  Failure to meet obligations as they fall due for
payment.
defered asset  An asset whose benefit is delayed
beyond the period expected for a current asset, but
which does not meet the definition of a fixed asset.
defered income  Revenue, such as a government
grant, is received in advance of performing the
related activity. The deferred income is held in the
balance sheet as a type of liability until performance
is achieved and is then released to the income
statement.
defered taxation  The obligation to pay tax is
defered (postponed) under tax law beyond the
normal date of payment.
depreciable amount  Cost of a non-current (fixed)
asset minus residual value.
depreciation  The systematic allocation of the
depreciable amount of an asset over its useful life.
The depreciable amount is cost less residual value.
derecognition  The act of removing an item from
the financial statements because the item no longer
satisfies the conditions for recognition.
difference on consolidation  Difference between fair
value of the payment for a subsidiary and the fair
value of net assets acquired, more commonly called
goodwill.
direct method (of operating cash flow)  Presents cash
inflows and cash outflows.
Directive  A document issued by the European Union
requiring all Member States to adapt their national law
to be consistent with the Directive.
**Financial accounting terms defined**

**director(s)** Person(s) appointed by shareholders of a limited liability company to manage the affairs of the company.

**disclosed, disclosure** An item which is reported in the notes to the accounts is said to be disclosed but not recognised.

**discount received** A supplier of goods or services allows a business to deduct an amount called a discount, for prompt payment of an invoiced amount. The discount is often expressed as a percentage of the invoiced amount.

**dividend** Amount paid to a shareholder, usually in the form of cash, as a reward for investment in the company. The amount of dividend paid is proportionate to the number of shares held.

**dividend cover** Earnings per share divided by dividend per share.

**dividend yield** Dividend per share divided by current market price.

**doubtful debts** Amounts due from credit customers where there is concern that the customer may be unable to pay.

**drawings** Cash taken for personal use, in sole trader or partnership business, treated as a reduction of ownership interest.

**earnings for ordinary shareholders** Profit after deducting interest charges and taxation and after deducting preference dividends (but before deducting extraordinary items).

**earnings per share** calculated as earnings for ordinary shareholders divided by the number of shares which have been issued by the company.

**effective interest rate** The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument.

**efficient markets hypothesis** Share prices in a stock market react immediately to the announcement of new information.

**endorsed** International financial reporting standards approved for use in Member States of the European Union through a formal process of endorsement.

**endorsement** See endorsed.

**enterprise** a business activity or a commercial project.

**entity, entities** Something that exists independently, such as a business which exists independently of the owner.

**entry price** The value of entering into acquisition of an asset or liability, usually replacement cost.

**equities analyst** A person who investigates and writes reports on ordinary share investments in companies (usually for the benefit of investors in shares).

**equity** A description applied to the ordinary share capital of an entity.

**equity accounting** Reports in the balance sheet the parent or group’s share of the investment in the share capital and reserves of an associated company.

**equity interest** See ownership interest.

**equity portfolio** A collection of equity shares.

**equity shares** Shares in a company which participate in sharing dividends and in sharing any surplus on winding up, after all liabilities have been met.

**eurobond market** A market in which bonds are issued in the capital market of one country to a non-resident borrower from another country.

**exit price** See exit value.

**exit value** A method of valuing assets and liabilities based on selling prices, as an alternative to historical cost.

**expense** An expense is caused by a transaction or event arising during the ordinary activities of the business which causes a decrease in the ownership interest.

**external reporting** Reporting financial information to those users with a valid claim to receive it, but who are not allowed access to the day-to-day records of the business.

**external users (of financial statements)** Users of financial statements who have a valid interest but are not permitted access to the day-to-day records of the company.

**fair value** The amount at which an asset or liability could be exchanged in an arm’s-length transaction between a willing buyer and a willing seller.

**faithful presentation** Qualitative characteristic, information represents what it purports to represent.

**financial accounting** A term usually applied to external reporting by a business where that reporting is presented in financial terms.

**financial adaptability** The ability of the company to respond to unexpected needs or opportunities.

**financial gearing** Ratio of loan finance to equity capital and reserves.

**financial information** Information which may be reported in money terms.

**Financial Reporting Standard** Title of an accounting standard issued by the UK Accounting Standards Board as a definitive statement of best practice (issued from 1990 onwards – predecessor documents are Statements of Standard Accounting Practice, many of which remain valid).

**financial risk** Exists where a company has loan finance, especially long-term loan finance where the
Financial accounting terms defined

**company** cannot relinquish its commitment. The risk relates to being unable to meet payments of interest or repayment of capital as they fall due.

**financial statements** Documents presenting accounting information which is expected to have a useful purpose.

**financial viability** The ability to survive on an ongoing basis.

**financing activities** Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

**fixed asset** An asset that is held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the reporting entity’s activities.

**fixed assets** See non-current assets.

**fixed assets usage** Revenue divided by net book value of fixed assets.

**fixed capital** Finance provided to support the acquisition of fixed assets.

**fixed cost** One which is not affected by changes in the level of output over a defined period of time.

**floating charge** Security taken by lender which floats over all the assets and crystallises over particular assets if the security is required.

**forecast** Estimate of future performance and position based on stated assumptions and usually including a quantified amount.

**format** A list of items which may appear in a financial statement, setting out the order in which they are to appear.

**forward exchange contract** An agreement to buy foreign currency at a fixed future date and at an agreed price.

**fully paid** Shares on which the amount of share capital has been paid in full to the company.

**fund manager** A person who manages a collection (portfolio) of investments, usually for an insurance company, a pension fund business or a professional fund management business which invests money on behalf of clients.

**gearing (financial)** The ratio of debt capital to ownership claim.

**general purpose financial statements** Documents containing accounting information which would be expected to be of interest to a wide range of user groups. For a limited liability company there would be: a balance sheet, a profit and loss account, a statement of recognised gains and losses and a cash flow statement.

**going concern basis** The assumption that the business will continue operating into the foreseeable future.

**goodwill** Goodwill on acquisition is the difference between the fair value of the amount paid for an investment in a subsidiary and the fair value of the net assets acquired.

**gross** Before making deductions.

**gross margin** Sales minus cost of sales before deducting administration and selling expenses (another name for gross profit). Usually applied when discussing a particular line of activity.

**gross margin ratio** Gross profit as a percentage of sales.

**gross profit** Sales minus cost of sales before deducting administration and selling expenses (see also gross margin).

**group** Economic entity formed by parent and one or more subsidiaries.

**highlights statement** A page at the start of the annual report setting out key measures of performance during the reporting period.

**historical cost** Method of valuing assets and liabilities based on their original cost without adjustment for changing prices.

**HM Revenue and Customs** (HMRC) The UK government’s tax-gathering organisation (formerly called the Inland Revenue).

**IAS** International Accounting Standard, issued by the IASB’s predecessor body.

**IASB** International Accounting Standards Board, an independent body that sets accounting standards accepted as a basis for accounting in many countries, including all Member States of the European Union.

**IASB system** The accounting standards and guidance issued by the IASB.

**IFRS** International Financial Reporting Standard, issued by the IASB.

**impairment** A reduction in the carrying value of an asset, beyond the expected depreciation, which must be reflected by reducing the amount recorded in the balance sheet.

**impairment review** Testing assets for evidence of any impairment.

**impairment test** Test that the business can expect to recover the carrying value of the intangible asset, through either using it or selling.

**improvement** A change in, or addition to, a non-current (fixed) asset that extends its useful life or increases the expected future benefit. Contrast with repair which restores the existing useful life or existing expected future benefit.

**income statement** Financial statement presenting revenues, expenses, and profit. Also called profit and loss account.
incorporation, date of. The date on which a company comes into existence.

indirect method (of operating cash flow) Calculates operating cash flow by adjusting operating profit for non-cash items and for changes in working capital.

insider information Information gained by someone inside, or close to, a listed company which could confer a financial advantage if used to buy or sell shares. It is illegal for a person who is in possession of inside information to buy or sell shares on the basis of that information.

institutional investor An organisation whose business includes regular investment in shares of companies, examples being an insurance company, a pension fund, a charity, an investment trust, a unit trust, a merchant bank.

intangible Without shape or form, cannot be touched.

interest (on loans) The percentage return on capital required by the lender (usually expressed as a percentage per annum).

interim reports Financial statements issued in the period between annual reports, usually half-yearly or quarterly.

internal reporting Reporting financial information to those users inside a business, at various levels of management, at a level of detail appropriate to the recipient.

inventory Stocks of goods held for manufacture or for resale.

investing activities The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

investors Persons or organisations which have provided money to a business in exchange for a share of ownership.

joint and several liability (in a partnership) The partnership liabilities are shared jointly but each person is responsible for the whole of the partnership.

key performance indicators Quantified measures of factors that help to measure the performance of the business effectively.

leasing Acquiring the use of an asset through a rental agreement.

legal form Representing a transaction to reflect its legal status, which might not be the same as its economic form.

leverage Alternative term for gearing, commonly used in the USA.

liabilities Obligations of an entity to transfer economic benefits as a result of past transactions or events.

limited liability A phrase used to indicate that those having liability in respect of some amount due may be able to invoke some agreed limit on that liability.

limited liability company Company where the liability of the owners is limited to the amount of capital they have agreed to contribute.

liquidity The extent to which a business has access to cash or items which can readily be exchanged for cash.

listed company A company whose shares are listed by the Stock Exchange as being available for buying and selling under the rules and safeguards of the Exchange.

listing requirements Rules imposed by the Stock Exchange on companies whose shares are listed for buying and selling.

Listing Rules Issued by the UK Listing Authority of the Financial Services Authority to regulate companies listed on the UK Stock Exchange. Includes rules on accounting information in annual reports.

loan covenants Agreement made by the company with a lender of long-term finance, protecting the loan by imposing conditions on the company, usually to restrict further borrowing.

loan notes A method of borrowing from commercial institutions such as banks.

loan stock Loan finance traded on a stock exchange.

long-term finance, long-term liabilities Money lent to a business for a fixed period, giving that business a commitment to pay interest for the period specified and to repay the loan at the end of the period. Also called non-current liabilities information in the financial statements should show the commercial substance of the situation.

management Collective term for those persons responsible for the day-to-day running of a business.

management accounting Reporting accounting information within a business, for management use only.

market value (of a share) The price for which a share could be transferred between a willing buyer and a willing seller.

marking to market Valuing a marketable asset at its current market price.

margin Profit, seen as the ‘margin’ between revenue and expense.

matching Expenses are matched against revenues in the period they are incurred (see also accruals basis).

material See materiality.

materiality Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.

maturity The date on which a liability is due for repayment.

maturity profile of debt The timing of loan repayments by a company in the future.
memorandum (for a company) Document setting out main objects of the company and its powers to act.
merger Two organisations agree to work together in a situation where neither can be regarded as having acquired the other.
minority interest The ownership interest in a company held by persons other than the parent company and its subsidiary undertakings. Also called a non-controlling interest.
net After making deductions.
net assets Assets minus liabilities (equals ownership interest).
net book value Cost of non-current (fixed) asset minus accumulated depreciation.
net profit Sales minus cost of sales minus all administrative and selling costs.
net realisable value The proceeds of selling an item, less the costs of selling.
neutral Qualitative characteristic of freedom from bias.
nominal value (of a share) The amount stated on the face of a share certificate as the named value of the share when issued.
non-controlling interest See minority interest.
non-current assets Any asset that does not meet the definition of a current asset. Also described as fixed assets.
non-current liabilities Any liability that does not meet the definition of a current liability. Also described as long-term liabilities.
notes to the accounts Information in financial statements that gives more detail about items in the financial statements.
off-balance-sheet finance An arrangement to keep matching assets and liabilities away from the entity’s balance sheet.
offer for sale A company makes a general offer of its shares to the public.
operating activities The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
operating and financial review Section of the annual report of many companies which explains the main features of the financial statements.
operating gearing The ratio of fixed operating costs to variable operating costs.
operating margin Operating profit as a percentage of sales.
operating risk Exists where there are factors, such as a high level of fixed operating costs, which would cause profits to fluctuate through changes in operating conditions.
ordinary shares Shares in a company which entitle the holder to a share of the dividend declared and a share in net assets on closing down the business.
ownership interest The residual amount found by deducting all of the entity’s liabilities from all of the entity’s assets. (Also called equity interest.)
par value See nominal value.
parent company Company which controls one or more subsidiaries in a group.
partnership Two or more persons in business together with the aim of making a profit.
partnership deed A document setting out the agreement of the partners on how the partnership is to be conducted (including the arrangements for sharing profits and losses).
partnership law Legislation which governs the conduct of a partnership and which should be used where no partnership deed has been written.
portfolio (of investment) A collection of investments.
portfolio of shares A collection of shares held by an investor.
preference shares Shares in a company which give the holder a preference (although not an automatic right) to receive a dividend before any ordinary share dividend is declared.
preliminary announcement The first announcement by a listed company of its profit for the most recent accounting period. Precedes the publication of the full annual report. The announcement is made to the entire stock market so that all investors receive information at the same time.
premium An amount paid in addition, or extra.
prepayment An amount paid for in advance for an benefit to the business, such as insurance premiums or rent in advance. Initially recognised as an asset, then transferred to expense in the period when the benefit is enjoyed. (Also called a prepaid expense.)
present fairly A condition of the IASB system, equivalent to true and fair view in the UK ASB system.
price–earnings ratio Market price of a share divided by earnings per share.
price-sensitive information Information which, if known to the market, would affect the price of a share.
primary financial statements The balance sheet, profit and loss account, statement of total recognised gains and losses and cash flow statement.
principal (sum) The agreed amount of a loan, on which interest will be charged during the period of the loan.
Financial accounting terms defined

private limited company (Ltd) A company which has limited liability but is not permitted to offer its shares to the public.

production overhead costs Costs of production that are spread across all output, rather than being identified with specific goods or services.

profit Calculated as revenue minus expenses.

profit and loss account Financial statement presenting revenues, expenses, and profit. Also called income statement.

prospective investor An investor who is considering whether to invest in a company.

prospectus Financial statements and supporting detailed descriptions published when a company is offering shares for sale to the public.

provision A liability of uncertain timing or amount.

provision for doubtful debts An estimate of the risk of not collecting full payment from credit customers, reported as a deduction from trade receivables (debtors) in the balance sheet.

prudence A degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that gains and assets are not overstated and losses and liabilities are not understated.

public limited company (plc) A company which has limited liability and offers its shares to the public.

purchase method Method of producing consolidated financial statements (see acquisition method).

purchases Total of goods and services bought in a period.

qualified audit opinion An audit opinion to the effect that: the accounts do not show a true and fair view; or the accounts show a true and fair view except for particular matters.

quality of earnings Opinion of investors on reliability of earnings (profit) as a basis for their forecasts.

quoted company Defined in section 262 of the Companies Act 1985 as a company that has been included in the official list in accordance with the provisions of Part VI of the Financial Services and Markets Act 2000, or is officially listed in an EEA state, or is admitted to dealing on either the New York Stock Exchange or the exchange known as Nasdaq.

realised profit, realisation A profit arising from revenue which has been earned by the entity and for which there is a reasonable prospect of cash being collected in the near future.

recognised An item is recognised when it is included by means of words and amount within the main financial statements of an entity.

recognition See recognised.

Registrar of Companies An official authorised by the government to maintain a record of all annual reports and other documents issued by a company.

relevance Qualitative characteristic of influencing the economic decisions of users.

reliability Qualitative characteristic of being free from material error and bias, representing faithfully.

replacement cost A measure of current value which estimates the cost of replacing an asset or liability at the date of the balance sheet. Justified by reference to value to the business.

reserves The claim which owners have on the assets of a company because the company has created new wealth for them over the period since it began.

residual value The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated cost of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

timed earnings Accumulated past profits, not distributed in dividends, available to finance investment in assets.

retained profit Profit of the period remaining after dividend has been deducted.

return The yield or reward from an investment.

return on capital employed Operating profit before deducting interest and taxation, divided by share capital plus reserves plus long-term loans.

return on total assets Operating profit before deducting interest and taxation, divided by total assets.

return on shareholders’ equity Profit for shareholders divided by share capital plus reserves.

return (in relation to investment) The reward earned for investing money in a business. Return may appear in the form of regular cash payments (dividends) to the investor, or in a growth in the value of the amount invested.

revaluation reserve The claim which owners have on the assets of the business because the balance sheet records a market value for an asset that is greater than its historical cost.

revenue Created by a transaction or event arising during the ordinary activities of the business which causes an increase in the ownership interest.

rights issue A company gives its existing shareholders the right to buy more shares in proportion to those already held.

risk (in relation to investment) Factors that may cause the profit or cash flows of the business to fluctuate.

sales See revenue, turnover.
**sales invoice**  Document sent to customers recording a sale on credit and requesting payment.

**secured loan**  Loan where the lender has taken a special claim on particular assets or revenues of the company.

**segmental reporting**  Reporting revenue, profit, cash flow assets, liabilities for each geographical and business segment within a business, identifying segments by the way the organisation is managed.

**share capital**  Name given to the total amount of cash which the shareholders have contributed to the company.

**share certificate**  A document providing evidence of share ownership.

**share premium**  The claim which owners have on the assets of a company because shares have been purchased from the company at a price greater than the nominal value.

**shareholders**  Owners of a limited liability company.

**shareholders’ funds**  Name given to total of share capital and reserves in a company balance sheet.

**shares**  The amount of share capital held by any shareholder is measured in terms of a number of shares in the total capital of the company.

**short-term finance**  Money lent to a business for a short period of time, usually repayable on demand and also repayable at the choice of the business if surplus to requirements.

**sole trader**  An individual owning and operating a business alone.

**specific purpose financial statements**  Documents containing accounting information which is prepared for a particular purpose and is not normally available to a wider audience.

**stakeholders**  A general term devised to indicate all those who might have a legitimate interest in receiving financial information about a business because they have a ‘stake’ in it.

**statement of changes in equity**  A financial statement reporting all items causing changes to the ownership interest during the financial period, under the IASB system.

**statement of principles**  A document issued by the Accounting Standards Board in the United Kingdom setting out key principles to be applied in the process of setting accounting standards.

**statement of recognised income and expense**  A financial statement reporting realised and unrealised income and expense as part of a statement of changes in equity under the IASB system.

**statement of total recognised gains and losses**  A financial statement reporting changes in equity under the UK ASB system.
Financial accounting terms defined

**UK ASB system** The accounting standards and company law applicable to corporate reporting by UK companies that do not report under the IASB system.

**understandability** qualitative characteristic of financial statements, understandable by users.

**unlisted** (company) Limited liability company whose shares are not listed on any stock exchange.

**unrealised** Gains and losses representing changes in values of assets and liabilities that are not realised through sale or use.

**unsecured creditors** Those who have no claim against particular assets when a company is wound up, but must take their turn for any share of what remains.

**unsecured loan** Loan in respect of which the lender has taken no special claim against any assets.

**value to the business** An idea used in deciding on a measure of current value.

**variance** The difference between a planned, budgeted or standard cost and the actual cost incurred. An adverse variance arises when the actual cost is greater than the standard cost. A favourable variance arises when the actual cost is less than the standard cost.

**working capital** Finance provided to support the short-term assets of the business (stocks and debtors) to the extent that these are not financed by short-term creditors. It is calculated as current assets minus current liabilities.

**working capital cycle** Total of stock holding period plus customers collection period minus suppliers payment period.

**work-in-progress** Cost of partly completed goods or services, intended for completion and recorded as an asset.

**written down value** See net book value.
Management accounting terms defined

The definition of one word or phrase may depend on understanding another word or phrase defined elsewhere in the reference list. Words in bold indicate that such a definition is available.

**ABC** See activity-based costing.

**AMTs** See advanced manufacturing technologies.

**absorb, absorbed** See absorption.

**absorption** The process by which overhead costs are absorbed into units of output, or ‘jobs’.

**absorption costing** All production costs are absorbed into products and the unsold inventory is valued at total cost of production.

**accounting** The process of identifying, measuring and communicating financial information about an entity to permit informed judgements and decisions by users of the information.

**accounting rate of return** Calculated by taking the average annual profits expected from a project as a percentage of the capital invested.

**accrual** See accrued expense.

**accrued expense (accrued liability)** An expense which remains unpaid at the accounting date and is therefore recognised as a liability.

**activity** any physical operation that takes place in an enterprise. For ABC see also unit activity, product-sustaining activities, batch-related activities and cost drivers.

**activity-based costing (ABC)** traces overhead costs to products by focusing on the activities that drive costs (cause costs to occur).

**activity cost pool** See cost pool.

**actual overhead cost** Overhead cost of the period, arising either through cash spending or through trade credit.

**advanced manufacturing technologies** New methods developed by engineers in order to compete more effectively.

**adverse variance** This arises when the actual cost is greater than the standard cost.

**allocate** To assign a whole item of cost, or of revenue, to a simple cost centre, account or time period.

**allocated, allocation** See allocate.

**annual report** A document produced each year by limited liability companies containing the accounting information required by law. Larger companies also provide information and pictures of the activities of the company.

**apportion** To spread cost over two or more cost units, centres, accounts or time periods on some basis which is a fair representation of how the cost item is used by each cost centre.

**apportioned, apportionment** See apportion.

**assets** Rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.

**average annual profit** Calculated as average annual cash flow minus annual depreciation.

**avoidable cost** One which may be eliminated by taking a particular action.

**balanced scorecard** Links performance measures for key goals in customer perspective, financial perspective, internal business perspective and learning and growth perspective.

**balance sheet** A statement of the financial position of an entity showing assets, liabilities and ownership claim.

**basic standard** A standard cost that remains a permanent basis for comparison.

**batch-related activities (in ABC)** Product-sustaining activities that are fixed for a given batch of products.

**benchmarking** is the process of measuring the organisation’s operations, products and services against those of competitors recognised as market leaders, in order to establish targets which will provide a competitive advantage.

**bottom-up budget** Initiated by inviting those who will implement the budget to participate in the process of setting the budget. Also called a participative budget.

**breakeven analysis** A technique of management accounting which is based on calculating the breakeven
Management accounting terms defined

point and analysing the consequences of changes in various factors calculating the breakeven point.

**breakeven chart** Graph that shows sales and costs over a range of activity, including the activity level at which total costs equal total sales and at which the business makes neither a profit nor a loss.

**breakeven point** That point of activity (measured as sales volume) where total sales and total costs are equal, so that there is neither profit nor loss.

**breakeven sales** See **breakeven point**.

**budget** A detailed plan which sets out, in money terms, the plans for income and expenditure in respect of a future period of time. It is prepared in advance of that time period and is based on the agreed objectives for that period of time, together with the strategy planned to achieve those objectives.

**budget committee** A group of people brought together to manage each stage of the budgetary process.

**budget manual** A document setting out procedures and instructions including the timetable for budget preparation, formats to be used, circulation lists for drafts, and arbitration procedures where conflicts begin to show themselves.

**budgetary planning and control** Specialist techniques to quantify the strategy of the enterprise.

**budgetary system** Serves the needs of management in making judgements and decisions, exercising planning and control and achieving effective communication and motivation.

**budgeted fixed overhead cost rate** Fixed overhead cost rate per unit set in advance. See **predetermined overhead cost rate**.

**business strategic planning** Involves preparing, evaluating and selecting strategy to achieve objectives of a long-term plan of action within a defined business activity.

**capital budgeting** A process of management accounting which assists management decision making by providing information on the investment in a project and the benefits to be obtained from that project, and by monitoring the performance of the project subsequent to its implementation.

**capital expenditure** Spending on resources which bring a long-term benefit to an organisation, in generating cash flows or providing other benefits relating to the purpose of the organisation.

**capital investment** See **capital expenditure**.

**capital investment appraisal** The application of a set of methods of quantitative analysis which give guidance to managers in making decisions as to how best to invest long-term funds.

**capital rationing** There is not sufficient finance (capital) available to support all the projects proposed in an organisation.

**cash flow projections** Statements of cash expected to flow into the business and cash expected to flow out over a particular period.

**cash flows** Calculated as profit before deducting depreciation and amortisation.

**contingency theory** An explanation that management accounting methods have developed in a variety of ways depending on the judgements or decisions required.

**contribution** Sales minus variable cost.

**contribution per unit** The sales price minus the variable cost per unit. It measures the contribution made by each item of output to fixed costs and profit.

**contribution per unit of limiting factor** Used in ranking, choosing the highest value of this ratio to make the most profitable use of restricted resources.

**control** The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. One of three functions of management that are supported by management accounting. See also **decision making** and **planning**.

**controllable cost** A cost which is capable of being regulated by a manager within a defined boundary of responsibility.

**controlling** See **control**.

**corporate strategic planning** Involves preparing, evaluating and selecting strategies to achieve objectives of a long-term plan of action for the corporate entity as a whole.

**cost centre** A unit of the organisation in respect of which a manager is responsible for costs under her or his control.

**cost code** A system of letters and numbers designed to give a series of unique labels which help in classification and analysis of cost information.

**cost coding** Codes used for recording costs in an accounting system.

**cost driver rate** Total costs in a **cost pool** divided by the number of times that the **activity** occurs.

**cost drivers** The factors that most closely influence the cost of an activity.

**cost of capital** The cost to the business of raising new finance.

**cost of quality** All costs incurred in achieving a quality product or service.

**cost-plus pricing** Setting a price based on full cost of production plus desired profit. Also called **full cost pricing**.
cost pool  The costs collected that relate to each activity.
cost(s)  An amount of expenditure on a defined activity. The word ‘cost’ needs other words added to it, to give it a specific meaning.
cost–volume–profit analysis  Emphasises the relationship between sales revenue, costs and profit in the short term.
creditors  Persons or organisations that are owed money by the entity.
current asset  An asset that is expected to be converted into cash within the trading cycle.
current liability  A liability that is expected to be repaid within a short period of time, usually within one year.
currently attainable standard  A standard cost based on expectations under normally efficient operating conditions.
debtors  Persons or organisations who owe money to the entity.
decision making  One of three functions of management which are supported by management accounting. See also planning and control.
depreciable amount  The cost of an asset, or another amount such as replacement cost substituted for cost, less its residual value.
depreciation  The systematic allocation of the depreciable amount of an asset over its useful life.
direct cost  Cost that is directly traceable to an identifiable unit, such as a product or service or department of the business, for which costs are to be determined.
directing attention  One of three functions of management accounting to support management actions of planning, decision making and control. See also keeping the score and solving problems.
discount rate  Most suitable rate of interest to be applied in calculating present value. Could be based on one particular type of finance but more usually is the cost of mixed sources.
discounting  The process of calculating present value of projected cash flows.
division  A part of the organisation where the manager has responsibility for generating revenues, controlling costs and producing a satisfactory return on capital invested in the division.
de-busine$$  Electronic business: the use of technology to automate business practices.

de-commerce  Electronic commerce: the use of electronic media for transactions between the company and its customers or suppliers; one aspect of e-business.

entity  An identifiable organisation for which accounting information is needed (e.g. limited liability company, public sector body). Also a legal/economic unit which exists independently of its owners.
faculity-sustaining activity  (in ABC)  Activity that is not driven by making products.
favourable variance  This arises when the actual cost is less than the standard cost.
feed forward control  Means making predictions of outputs expected at some future time and then quantifying those predictions, in management accounting terms.
feedback control  Involves comparing outputs achieved against outputs desired and taking corrective action if necessary.
financial accounting  A term usually applied to external reporting by a business where that reporting is presented in financial terms.
financial statements  Documents containing accounting information presented to meet the needs of users.
fixed asset  An asset that is held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes on a continuing basis in the reporting entity’s activities.
fixed cost  One which is not affected by changes in the level of output over a defined period of time.
flexible budget  A budget that is designed to change when the volume of activity changes, to achieve comparability.
full cost of production  Direct cost plus indirect cost of production. Also calculated as prime cost plus production overhead cost.
full cost pricing  See cost-plus pricing.
functional strategic planning  Also called operational planning. The detailed plans by which those working within an organisation are expected to meet the short-term objectives of their working group, based on the functions that are carried out by the group.
gross  Before making deductions.
ideal standard  A standard cost set under the most efficient operating conditions.
impairment  An asset is impaired when the business cannot expect to recover the carrying value of the intangible asset (as shown in the balance sheet), either through using it or through selling it.

imposed budget  See top-down budget.
icremental analysis  Means analysing the changes in costs and revenues caused by a change in activity.
icremental budget  Prepared by adding a percentage to the budget of the previous year, usually to represent the effects of inflation.
Management accounting terms defined

**incremental costs** The additional costs that arise from an activity of the organisation. To justify incurring incremental costs it is necessary to show they are exceeded by incremental revenue.

**incremental revenue** The additional revenue that arises from an activity of the organisation. To justify accepting incremental revenue it is necessary to show it exceeds incremental costs.

**indirect cost** Cost that is spread over a number of identifiable units of the business, such as products or services or departments, for which costs are to be determined.

**indirect labour** Labour costs that cannot be allocated directly to an identifiable unit for which costs are to be determined.

**indirect materials** Materials costs that cannot be allocated directly to an identifiable unit for which costs are to be determined.

**integrated system** Accounting records that serve the needs of both financial accounting and management accounting.

**internal rate of return** The discount rate at which the present value of the cash flows generated by the product is equal to the present value of the capital invested, so that the net present value of the project is zero.

**internal reporting** Reporting financial information to those users inside a business, at various levels of management, at a level of detail appropriate to the recipient.

**inventory, cost of holding** The costs related to storing inventory until it is sold.

**inventory, cost of ordering** The administrative costs related to buying and receiving materials.

**investment centre** A unit of the organisation in respect of which a manager is responsible for capital investment decisions as well as revenue and costs.

**invoice** A document sent by a supplier to a customer showing the quantity and price of goods or services supplied.

**job cost** The cost of a product or service provided to a customer, consisting of direct and indirect costs of production. See also product cost.

**job cost record** Shows the costs of materials, labour and overhead incurred on a particular job.

**job-costing system** A system of cost accumulation where there is an identifiable activity for which costs may be collected. The activity is usually specified in terms of a job of work or a group of tasks contributing to a stage in the production or service process.

**just-in-time purchasing** is a system of contracts with suppliers to deliver goods as closely as possible to the time when they are required for operations. Just-in-time theory can be applied to manufacturing, management systems, etc.

**keeping the score** One of three functions of management accounting to support management actions of planning, decision making and control. See also directing attention and solving problems.

**limiting factor** An item which is temporarily restricted in availability.

**line item budget** Each line in the budget relates to a function in the organisation.

**liquidity** The extent to which a business has access to cash or items which can readily be exchanged for cash.

**long-range planning** Begins with a vision statement setting out a vision for the future direction of the organisation. From this vision the long-range objectives are set covering a period of perhaps three to five years.

**management** Collective term for those persons responsible for the day-to-day running of a business.

**management accounting** Reporting accounting information within a business, for management use only.

**management control system** A system of organisational information-seeking and gathering, accountability and feedback designed to ensure that the enterprise adapts to changes in its substantive environment and that the work behaviour of its employees is measured by reference to a set of operational sub-goals so that the discrepancy between the two can be reconciled and corrected for.

**margin** Frequently used as a short description of profit, particularly in the financial press. May be expressed as a percentage of sales or percentage of revenue.

**margin of safety** The difference between the breakeven sales and the normal level of sales (measured in units or £s of sales).

**marginal costing** See variable costing.

**master budget** Combination of budgeted profit and loss account, cash flow statement and balance sheet, created from detailed budgets brought together within a finance plan.

**mutually exclusive** Investment projects that are competing for scarce resources, where choosing one eliminates another.

**net** After making deductions.

**net present value** The net present value (of a project) is equal to the present value of the cash inflows minus the present value of the cash outflows, all discounted at the cost of capital.
non-controllable cost One which is not capable of being regulated by a manager within a defined boundary of responsibility, although it may be a cost incurred so that the responsibility may be exercised.

non-financial performance measures Measurement of performance using targets that are not available in the financial reporting system.

normal level of activity Estimated by management, taking into account the budgeted level of activity in recent periods, the activity achieved in recent periods, and the expected output from normal working conditions.

operational budgets Budgets representing the quantification of operational planning, including materials and labour budgets.

operational planning The detailed plans by which those working within an organisation are expected to meet the short-term objectives of their working group. See also functional strategic planning.

opportunity cost A measure of the benefit sacrificed when one course of action is chosen in preference to another. The measure of sacrifice is related to the best rejected course of action.

output The product or service provided by the enterprise or one of its operating units.

overhead cost Cost that cannot be identified directly with products or services. See also indirect costs.

overhead cost rate Overhead cost divided by a measure of activity such as production to give a cost per unit of activity.

overhead cost recovery Absorbing overhead cost into a unit of product so that the overhead cost will eventually be recovered in the sale of the product.

over-recovered fixed overhead cost The overhead recovered (applied) using a predetermined overhead cost rate is greater than the actual overhead cost of the period.

ownership interest The residual amount found by deducting all of the entity’s liabilities from all of the entity’s assets.

participative budget See bottom-up budget.

payback period The length of time required for a stream of cash inflows from a project to equal the original cash outlay.

percentage mark-up on cost adds a percentage to the total cost to calculate a selling price.

performance evaluation Requires the management accountant to decide on what to measure, plan how to report and consider the behavioural aspects.

period costs Costs that are treated as expenses in the period in which they are incurred.

planning Involves setting objectives, then establishing, evaluating and selecting strategy, tactics and actions required to achieve those objectives. One of three functions of management which are supported by management accounting. See also control and decision making.

planning programming budget system (PPBS) An output-based approach to budgets that focuses on programmes of action in the enterprise.

post-completion audit A review of the actual results of a project in order to compare these with the expectations contained in the project proposals.

predetermined overhead cost rate Estimated before the start of a reporting period.

prepayments Expenses paid in advance, such as rent or insurance, where a future benefit remains at the accounting date.

present value A sum of £1 receivable at the end of n years when the rate of interest is r% per annum equals

\[
\frac{1}{(1 + r)^n}
\]

where r represents the annual rate of interest, expressed in decimal form, and n represents the time period when the cash flow will be received.

primary records Provide the first evidence that a transaction or event has taken place.

prime cost of production Equal to the total of direct materials, direct labour and other direct costs.

product cost Cost associated with goods or services purchased, or produced, for sale to customers. See also job cost.

product differentiation The business may be able to charge a higher price (a premium) for the reputation or quality of its product.

product life cycle The sequence of development of a product from initial development through maturity of sales to eventual decline in sales.

product-sustaining activities (in ABC) Activities that are performed to enable output of products but are not closely dependent on how many units are produced.

production Creating output in a business process, by using materials, labour and other resources available within the business.

production cost centre Cost centre that produces output of goods or services.

production overhead (cost) Comprises indirect materials, indirect labour and other indirect costs of production.

production plan Sets out quantities of resource inputs required, for use in operational budgets.

products See output.
Management accounting terms defined

profit The increase in the ownership interest in an entity over a specified period of time, due to the activities of the entity. The word ‘profit’ needs other words added to it, to give it a specific meaning.

profit centre A unit of the organisation in respect of which a manager is responsible for revenue as well as costs.

profit margin Profit as a percentage of sales.

profitability The ability to generate profit, based on a comparative measure e.g. profit as a percentage of sales; profit per month; profit related to capital investment.

profitability index The present value of cash flows (discounted at the cost of capital) divided by the present value of the investment intended to produce those cash flows.

profit-volume chart A graph showing on the horizontal axis the volume, measured by activity level in £s of sales, and on the vertical axis the profit at that activity level.

profit/volume ratio Contribution as a percentage of sales value.

recovered, recovery Costs are recovered by charging a selling price that covers costs and makes a profit.

revenue Is created by a transaction or event arising during the ordinary activities of the business which causes an increase in the ownership interest.

sales Delivering goods or services to a customer, either for cash or on credit terms.

sales budget Budget of sales volumes and prices for a future period.

scrap Unwanted material sold for disposal, usually at a very low price in relation to its original cost.

semi-variable cost One which is partly fixed and partly varies with changes in the level of activity, over a defined period of time.

sensitivity analysis Asks ‘what . . . if’ questions such as ‘What will be the change in profit if the selling price decreases by 1%?’ or ‘What will be the change in profit if the cost increases by 1%?’

service cost centre Cost centre that provides services to other cost centres within the organisation.

short-term finance Money lent to a business for a short period of time, usually repayable on demand and also repayable at the choice of the business if surplus to requirements.

single period capital rationing Capital rationing in one period only during the life of a project (usually in the first period).

solving problems One of three functions of management accounting to support management actions of planning, decision making and control. See also directing attention and keeping the score.

standard cost Target cost which should be attained under specified operating conditions. Expressed in cost per unit.

standard hour The amount of work achievable, at standard efficiency levels, in one hour.

statement (from supplier). A document sent by a supplier to a customer at the end of each month summarising all invoices awaiting payment by the customer.

step cost A fixed cost which increases in steps over a period of several years.

strategic management accounting The provision and analysis of financial information on the firm’s product markets and competitors’ costs and cost structures and the monitoring of the enterprise’s strategies and those of its competitors in these markets over a number of periods.

strategic planning Involves preparing, evaluating and selecting strategies to achieve objectives of a long-term plan of action.

strategy A plan setting out the actions and resources needed to achieve a stated objective of the long-term plan.

return (in relation to investment) The reward earned for investing money in a business. Return may appear in the form of regular cash payments (dividends) to the investor, or in a growth in the value of the amount invested.
sunk cost Cost that has been incurred or committed prior to a decision point. It is not relevant to subsequent decisions.

time value of money The name given to the idea that £1 invested today will grow with interest rates over time (e.g. £1 become £1.10 in one year’s time at a rate of 10%).

top-down budget Set by management without inviting those who will implement the budget to participate in the process of setting the budget. Also called an imposed budget.

total cost Calculated as variable cost plus fixed cost; or direct cost plus indirect cost; or product cost plus period cost.

total product cost Comprises prime cost plus production overhead cost.

trade creditors Persons (suppliers) who supply goods or services to a business in the normal course of trade and allow a period of credit before payment must be made.

trade debtors Persons (customers) who buy goods or services from a business in the normal course of trade and take a period of credit before paying what they owe.

traditional approach to overhead costs. Allocate and apportion to cost centres and then absorb into products which pass through those cost centres.

transfer price The price charged between two divisions of an organisation in transferring goods and services between each other.

turnover The sales of a business or other form of revenue from operations of the business.

unavoidable cost A cost that is not eliminated by taking a particular action.

under-recovered fixed overhead cost The overhead recovered (applied) using a predetermined overhead cost rate is less than the actual overhead cost of the period.

unit activity (in ABC) an activity that is performed each time a product is produced.

unit cost The cost of one unit of output.

value chain A way of describing and analysing the sequence of activities that bring on product/service from initial stage of production to final stage of delivery.

variable cost One which varies directly with changes in the level of output, over a defined period of time.

variable costing Only variable costs of production are absorbed into products and the unsold inventory is valued at variable cost of production. Fixed costs of production are treated as a cost of the period in which they are incurred.

variance The difference between a planned, budgeted or standard cost and the actual cost incurred. An adverse variance arises when the actual cost is greater than the standard cost. A favourable variance arises when the actual cost is less than the standard cost.

variance analysis Quantitative breakdown of cost variance into main causes, e.g. price and usage.

waste Any materials that have no value.

working capital Finance provided to support the short-term assets of the business (inventory and debtors) to the extent that these are not financed by short-term creditors. It is calculated as current assets minus current liabilities.

work-in-progress A product or service that is partly completed.

zero-based budget (ZBB) Budget preparation starts with a blank sheet of paper and justifies every item entered.