Glossary of Financial Terms

Have you ever found yourself a little bamboozled by the terminology used in financial activities? If so, use this glossary to keep you on track.

Basic Financial Terms

Some of the more straightforward financial terms that you might come across are listed below.

Accounting Manual: A document that details the accounting policies and procedures of a business. It normally contains a list of account codes or chart of accounts. The way a company treats depreciation is an example of an accounting policy which would be set out in the accounting manual.

Accounting Period: The period for which a company prepares its accounts. Management accounts may be produced internally on a monthly or quarterly basis, whilst financial accounts will be made for a period of one year. An accounting period starts when a company begins trading and ends either:

- one year after starting to trade
- at the end of the period of account, or
- at the start of a winding-up of operations

Accounts: The documents prepared by accountants which give an indication of how a business has performed over a specified period (usually a year).

Accounts Payable (or Creditors): The debts shown on the balance sheet of a buyer, when goods or services have been bought on credit.

Accounts Receivable (or Debtors): The money owed by customers when they have been sold goods or services on credit.

Accruals: Provisions for liaibilities incurred in an accounting period for which an invoice has not been received.

Accruals Basis: A process of revenue calculation that disregards the receiving or dispersal of cash. Instead, services already rendered are recognised as revenue, and services utilised (or efforts expended) are registered as expenses.

Book Value: The amount of money at which an asset is recorded in the financial statements.

Avoidable Cost: Costs not continuing if an operation is deleted or modified.

Balance Sheet: A statement of financial status at a given point in time.

Budget: A plan of action expressed in quantitative monetary terms, i.e. a statement of how much money you will allocate to different items or activities that you or your team will undertake.

Capital: Most commonly refers to owner’s equity i.e. the money owners have put into the business.

Capital Cost: A capital cost is the cost of purchasing a fixed asset.

Capital Expenditure (or Capex): Money spent on a major project or asset, such as premises. Capital expenditure is given a value on the balance sheet rather than being written off to the Profit and Loss Account.

Cash Basis: An accounting process where the timing of cash receipts and payments is the sole calculating factor when determining income and expenses.

Cash Budget: A statement of planned cash receipts and payments.

Cash Flow Forecast: A cash flow forecast is a way of projecting the likely cash that will flow through the organisation and is useful for predicting any shortfalls that may arise. It is different to the P&L as it shows only cash and it records the likely timing of cash payments and receipts, usually on a monthly basis. The P&L shows income and expenditure in the period when an invoice is issued or received, not when the actual cash is physically received or paid out.

Contribution Margin: Revenue from sales, minus all variable costs.

Cost: Financial sacrifice made for goods or services. May be outlay or opportunity costs.

Cost Centre: The small responsibility centre for costs. For instance, this could be a department or even a sub-division of a department like a particular assembly line within an assembly department.

Cost of Goods Sold: Cost of acquired and resold merchandise.

Cost of Sales: Synonymous with cost of goods sold.

Current Assets: Cash plus assets that are likely to be converted to cash within the operating cycle (usually within one year).

Current Liabilities: Existing debts that will be due to be paid within either the coming year.

Depreciation: Depreciation spreads the cost of using an asset over the length of time which it is in use. This cost is calculated as the cost of purchase less the resale value at the end of the useful economic life.

Dividend: A way of distributing the profits of a business amongst its shareholders. If a dividend is paid, it is usually paid annually.

Earnings: The excess of revenues over expenses.

Expense: A gross decrease in assets from the purchasing of goods and services.

Fixed Assets: An item that is purchased by your organisation for use in its operations. You will be able to use it for more than a year as it shouldn't wear out or end up being of no benefit to you before the 12 months is up.

Tangible Fixed Assets: Physical assets, also referred to as 'property, plant and equipment', or 'plant assets'.

Fixed Cost: A cost that is not affected by a change of related total activity or volume during a set time period. A cost is fixed if it will not vary with the level of work or production that is taking place, during a given period of time.

Goodwill: The value of a business over and above its net tangible assets. This value is derived largely from the market value

Gross Profit: The profits made by a business before overheads and other fixed costs. Essentially gross profit = goods sold - cost of goods sold.

Income: The excess of revenues over expenses. Income and cash are different things. Income is another word for the sales that have been invoiced or funding that has been awarded. Cash is the physical money going into your organisation's bank account when the invoice or funding is paid.

Intangible Assets: A class of non-physical, long-lived assets, e.g. patents and trademarks.

Liabilities: The money that an organisation is commited to pay another at some point in the future.

Losses: The opposite of profits i.e. when an organisation spends more than it earns.

Management Accounts: Accounts which are prepared for use when managing the business.

Net Income: The calculation for a given period of time which registers the excess of revenues and gains over expenses and losses.

Net Current Assets: Current assets minus current liabilities.

Net Profit: The total profit made by the business after overheads and other fixed costs have been deducted, but before any dividends and tax payments have been made.

Operating Cycle: The time span during which cash paid for acquisitions ultimately results in cash paid by purchasers. The cycle runs as follows: cash spent on acquisitions that are used to produce output, which is sold to customers, who pay cash for their purchases.

Opportunity Cost: The potential contribution to profit foregone in order to utilise limited resources in another area.

Payback Period: The amount of time taken to recoup, in terms of cash inflows, the initial amount of outlay.

Prime Costs: Direct-material cost plus direct-labour cost.

Product Costs: Costs identified with goods produced, or goods purchased for resale.

Profit: The capital left in the business when all liabilities have been met.

Profit and Loss Account (or P&L): The P&L allows you to understand whether, over a chosen period of time (often a month or year), the income of an organisation has been greater than the expenditure. In other words, it shows whether the organisation is making a profit/surplus or a loss/deficit.

Revenue Cost: The cost of purchasing an item for use within your organisation. The item is useful to your organisation for a year or less. It will be used up or stop being of benefit by the time 12 months is up.

Straight-Line Depreciation: A calculation of depreciation that allocates the same cost to an asset for each successive year of its useful life.

Sunk Cost: Also referred to as 'historical cost', this is a cost that has already been incurred, and is therefore irrelevant to the future decision-making process.

Tangible Assets: An asset that can be touched and seen, such as land and buildings, fixtures and fittings.

Transfer Price: The amount charged for a product or service provided by one segment of an organisation, to another segment within that same organisation. Transfer prices are prices charged internally, between different parts of the same organisation, for services or products.

Uncontrollable Cost: A cost that, within a given time span, cannot be affected by the efforts of the manager of a responsibility centre.

Variable Cost: A cost that changes in total in direct proportion to changes in the related total activity or volume. A variable cost varies in direct proportion to activity.

Variance: The unexpected deviation of actual results from those budgeted or expected.

Working Capital: Current assets and current liabilities i.e the amount of money tied up in the day to day operations of the business.

Zero-Base Budgeting (or ZBB): A budgeting practice in which managers are asked to justify all of their activities as if they were being undertaken for the first time.

Related Items

Related Resources

- An Introduction to the Key Financial Documents
- Finance Fundamentals: Internet Links and References