FINANCIAL TRAINING AUSTRALIA

Glossary Of Financial and Accounting Terms

A

A-IFRS: The Australian equivalent of the International Financial Reporting Standards. These are part of global accounting standards that determine the accounting treatment of items in Annual Reports (published financial statements.)

Absorption Costing: A method of costing which allocates all costs, **variable** and **fixed**, direct and indirect to units of production or specific services. Also referred to as Total Absorption Costing.

Account: A section in a ledger devoted to a single aspect of a business (e.g. a Bank account, Wages account, Office expenses account).

Accounting: The process of gathering and preparing financial information about a business or other organisation in a form that provides accurate and useful records and enables decisions to be made.

Accounting cycle: This covers everything from opening the 'books' at the start of the year to closing them at the end. In other words, everything you need to do in one accounting year accounting wise. Reference is still made to 'books' even though most accounts are computerised.

Accounting equation: The formula used to prepare a Balance Sheet: **Assets = Liabilities + Equity**.

Accounts Payable: The money owed to a supplier or Creditor for delivered goods or completed services. The money is a liability of the business or organisation and will appear on the Balance Sheet.

Accounts Receivable: The money that is owed to a business or organisation by its customers. This money is an asset of the business or organisation and will appear on the Balance Sheet.

Accruals or Accrued expenses: If during the course of business certain charges are incurred but no invoice is received then these charges are referred to as accruals (they 'accrue' or increase in value). A typical example is interest payable on a loan where you have not yet received a bank statement. These items (or an estimate of their value) should still be included in the **Profit & Loss Account/Income Statement**. When the real invoice is received, an adjustment can be made to correct the estimate. Accruals can also apply to the income side.

Accrual method of accounting: Under the accrual method of accounting, income is reported at the time it is earned, whether or not it has been received. Likewise, expenses are reported at the time they are incurred, whether or not the expense has been paid. A **Profit & Loss Account/Income Statement** is prepared on an accruals basis.

Accumulated Depreciation: This is the total of depreciation charged against a certain asset since its acquisition. It is shown on the **Balance Sheet** as a deduction from the original cost of the asset.

Acid test ratio: See **Quick Ratio**

Activity Based Costing: A method of costing introduced in the early 1990's which attempts to more accurately allocate costs to products or services by identifying cost drivers. Instead of using broad arbitrary percentages to allocate costs, Activity Based Costing (ABC) seeks to identify cause and effect relationships to objectively assign costs. Once costs of the activities have been identified, the cost of each activity is attributed to each product/ service to the extent that the product/service uses the activity. In this way ABC often identifies areas of high overhead costs and so directs attention to finding ways to reduce the costs or to charge more for costly services.

Amortisation: The depreciation of an intangible asset (e.g. license, patent) over a fixed period of time. The term may also be used to describe spreading the interest on a loan over the life of the loan.

Annualise: To convert anything into a yearly figure. E.g. if profits are reported as running at $10k a quarter, then they would be $40k if annualised. If a credit card interest rate was quoted as 1% a month, it would be annualised as 12%.

Appropriations: Payments made out of the net profits of a business (usually a partnership, limited company or corporation).

Arrears: Supplier invoices which should have been paid. For example, if you have forgotten to pay your last 3 months' rent, then you are said to be 3 months in arrears on your rent.

Assets: Assets represent what a business owns or is due. Equipment, vehicles, buildings, accounts receivable, money in the bank and cash are all examples of the assets of a business. Typical breakdown includes **'Current assets'** and **'Non-Current assets'**. Non Current usually includes equipment, buildings, plant, vehicles etc. Current refers to cash, money in the bank, accounts receivable or debtors, inventory or stock etc.

Associate or **Associated Company** - An investment where the shareholding is more than 20% but less than 50% and no dominant influence is exercised.

At cost: The 'at cost' price usually refers to the price originally paid for something, as opposed to, say, the retail price or current market value.

Audit: Systematic examination and verification of a firm's books of account, transaction records, other relevant documents, and physical inspection of inventory by qualified accountants (called auditors). Audits are performed to ascertain the validity and reliability of information; also to provide an assessment of a system's internal control. The goal of an audit is to express an opinion on the organisation or system (etc.) in question, under evaluation based on work done on a test basis.

Audit Trail: A list of transactions in the order they occurred.

Australian Tax Office (ATO): The Government Department responsible for collecting tax.

B

Bad Debts: The value of un-recoverable debts from customers. Real bad debts (where it is known that payment will not be received) or those that are likely to happen, are deducted as expenses in the **Profit & Loss Account/Income Statement** and the total provision at the year end is deducted from the amounts shown as **Receivables** in the Balance Sheet.

Bad Debts Provision: An account used to record an estimate of bad debts for the year (usually as a percentage of sales). Typically a monthly amount for bad debts will be charged to the Profit and Loss Account throughout the year and then adjusted at the year end or earlier for actual bad debts incurred.

Balance Sheet: A statement showing the financial position (the assets, liabilities and equity) of an individual, company or organisation on a certain date. The term ‘balance sheet’ implies that the total assets exactly equal the total of the **liabilities** and **equity** (a.k.a. Net Worth). This is also referred to as the **Statement of Financial Position.**

Baseline Budgeting: See **Incremental Budgeting**.

Bankrupt: If an individual or unincorporated company has greater liabilities than it has assets, the person or business can petition for, or be declared by its creditors, bankrupt. In the case of a limited company or corporation in the same position, the term used is **insolvent**.

Below the line: This term was applied to items within a business which would not normally be associated with the everyday running of a business. This term is not usually used anymore due to changes in reporting guidelines.

Bill: A term typically used to describe a purchase invoice (e.g. an invoice from a supplier).

Borrowings: Loans.

Bought Ledger: See **Purchase Ledger.**

Break Even Analysis: The calculation of the break even point, this being the level of sales volume where there is zero profit or loss.

Burn Rate: The rate at which a company spends its money. Example: if a company had cash reserves of $120m and it was currently spending $10m a month, then you could say that at the current ‘burn rate’ the company will run out of cash in 1 year.

C

CAGR: (Compound Annual Growth Rate) The year on year growth rate required to show the change in value (of an investment) from its initial value to its final value. If a $1 investment was worth $1.52 over three years, the CAGR would be 15% [(1 x 1.15) x 1.15 x 1.15].

Called-up Share capital or Equity: The value of unpaid (but issued shares) which a company has requested payment for. See Paid-up Share Capital.

Capex: A shortened form of Capital Expenditure. This is where an asset is purchased which is assessed as having an useful life of more than 12 months. It is therefore treated as a **Fixed** or **Non Current Asset**.

Capital: An amount of money put into the business as opposed to money earned by the business. See **Equity**.

Capital account: A term usually applied to the owners’ **Equity** in the business.

Capital Assets: See **Fixed Assets** or **Non Current Assets**.

Capital Employed (CE): This is effectively the total investment made in the company. While there are a number of ways of calculating it, it is commonly expressed as Non Current Assets plus Current assets less Current liabilities. In general, it represents the capital investment necessary for a business to function. Consequently, it is not a measure of assets, but of capital investment: stock or shares and long-term liabilities.

Capital Gains Tax: When a fixed asset/non current asset is sold at a profit, the profit may be liable to a tax called Capital Gains Tax.

Cash Accounting: This term describes an accounting method whereby only invoices and bills which have been paid are accounted for. However, for most types of business in the Australia, as far as the Australian Tax Office are concerned, as soon as you issue an invoice (paid or not), it is treated as revenue and must be accounted for. An exception is GST: Customs & Excise normally require you to account for GST on an accrual basis, however there is an option called ‘Cash Accounting’ whereby only paid items are included as far as GST is concerned (e.g. if most of your sales are on credit, you may benefit from this scheme).

Cash Book: A book where a business’s cash sales and purchases are entered. A cash book can also be used to record the transactions of a bank account. This is now normally computerised - but the term 'book' is still used!

Cash Flow: A report which shows the flow of money in and out of the business over a period of time.

Cash Flow Forecast (Budget): A report which estimates the cash flow in the future (usually required by a bank before it will lend you money, or take on your account). This is vital for every business.

Cash Flow Statement: A statement listing all the cash receipts and cash payments – including asset purchases – made during a specific time period. (Also known as the Statement of Cash Flows.) This is a historic document as opposed to the **Cash Flow Forecast** which looks at the future. The Cash Flow Statement is one of the key financial statements in Annual Reports. It distinguishes cash flows between those generated or used by Operating, Investing and Financing Activities.

Cash in Hand: Physical cash held i.e. petty cash and cash in the till.

Charge Back: Refers to a credit card order which has been processed and is subsequently cancelled by the cardholder contacting the credit card company directly (rather than through the seller). This results in the amount being ‘charged back’ to the seller (often incurs a small penalty or administration fee to the seller).

Chart of Accounts: A list of all the accounts of a business and their numbers, arranged according to their order in the ledger.

Closing the 'books': A term used to describe the journal entries necessary to close the sales and expense accounts of a business at year end by posting their balances to the Profit and Loss account, and ultimately to close the Profit and Loss account too by posting its balance to a capital or other account.

Compensating error: A double-entry term applied to a mistake which has cancelled out another mistake.

Compound interest: Apply interest on the capital plus all interest accrued to date. E.g. A loan with an annually applied rate of 10% for 1000 over two years would yield a gross total of 1210 at the end of the period (year 1 interest=100, year two interest=110). The same loan with **simple interest** applied would yield 1200 (interest on both years is 100 per year).

Contra account: An account created to offset another account. E.g. a Sales contra account would be Sales Discounts. They are accounts included in the same section of a set of books, which when compared together, give the net balance. Example: Sales=10,000 Sales Discounts=1,000 therefore Net Sales=9,000. This example, affecting the revenue side of a business, is also referred to as **Contra revenue**. The tell-tale sign of a contra account is that it has the opposite balance to that expected for an account in that section (in the above example, the Sales Discounts balance would be shown in brackets – e.g. it has a debit balance where Sales has a credit balance).

Contributed Equity: The value of issued shares which have been paid for. See **Paid-up Share Capital.**

Contribution: The difference between the sales price per unit and its **Variable Cost**. This is a contribution to the **Fixed Costs**.

Control Account: An account held in a ledger which summarises the balance of all the accounts in the same or another ledger. Typically each subsidiary ledger will have a control account which will be mirrored by another control account in the nominal ledger.

Cook the 'books': Falsify a set of accounts. See also **creative accounting**.

Cost accounting: An area of **management accounting** which deals with the costs of a business in terms of enabling the management to manage the business more effectively.

Cost-based pricing: Where a company bases its pricing policy solely on the costs of manufacturing rather than current market conditions.

Cost benefit analysis: is a term that refers both to helping to appraise, or assess, the case for a project, program or policy proposal and an approach to making economic decisions of any kind. Under both definitions the process involves, whether explicitly or implicitly, weighing the total expected costs against the total expected benefits of one or more actions in order to choose the best or most profitable option.

Cost centre: Splitting up your expenses by department. E.g. rather than having one account to handle all power costs for a company, a power account would be opened for each department. You can then analyse which department is using the most power, and hopefully find a way of reducing those costs.

Cost Drivers: These are factors that influence or contribute to the expense of business operations.

Cost Object: Something that you wish to know the cost of. It can be a product or service.

Cost of finished goods: The value (at cost) of newly manufactured goods shown in a business's manufacturing account. The valuation is based on the raw materials cost, plus **Direct Costs** involved in manufacturing, plus a share of manufacturing overheads.

Cost of Goods Sold (COGS): A formula for working out the direct costs of your stock/inventory sold over a particular period. The formula is: Opening inventory/stock + purchases – closing inventory/stock. When COGS are deducted from sales, the result is **Gross Profit**.

Cost of Sales: Effectively the same as **Costs of Goods Sold**. Cost of Sales is usually the term applied to service businesses and therefore represents the direct costs of delivering the service - usually mainly salaries and wages.

Creative accounting: A questionable (!) means of making a company's figures appear more (or less) appealing to shareholders etc.

Credit: A column in a journal or ledger to record the 'From' side of a transaction (e.g. if you buy some petrol using a cheque then the money is paid from the bank to the petrol account, you would therefore credit the bank when making the journal entry).

Credit Note: A sales invoice in reverse. A typical example is where you issue an invoice for $100, the customer then returns $25 worth of the goods, and so you issue the customer with a credit note to say that you owe the customer $25.

Creditors: A list of suppliers to whom the business owes money. Also known as **Payables** or **Accounts Payable**.

Current Assets: These include money in the bank, petty cash, money received but not yet banked (see **'cash in hand'**), money owed to the business by its customers, raw materials for manufacturing, and stock bought for re-sale. They are termed 'current' because they are expected to be used or turn into cash within 12 months.

Current cost accounting: The valuing of assets, stock/inventory, raw materials etc. at current market value as opposed to its **historical cost**.

Current Liabilities: These include bank overdrafts, short term loans (less than a year), and what the business owes its suppliers. They are termed 'current' for the same reasons outlined under 'current assets' in the previous paragraph, in that they are due for payment within 12 months.

Current ratio: A liquidity ratio measuring the ability of a company to pay its bills. It is calculated by dividing current assets by current liabilities – this ratio is also known as the **Working Capital Ratio**. It is usually expressed as a number, rather than a percentage, and will vary depending on the industry.

D

Days Sales Outstanding (DSO): How long on average it takes a company to collect the money owed to it by its customer/clients.

Debenture: A type of fixed-interest security, issued by companies (as borrowers) in return for medium and long-term investment of funds. A debenture is evidence of the borrower's debt to the lender.

Debit: A column in a journal or ledger to record the 'To' side of a transaction (e.g. if you are paying money into your bank account you would debit the bank when making the journal entry).

Debtors: A list of customers who owe money to the business. Also known as **Receivables** or **Accounts Receivable**.

Debtors (control account): An account in the nominal ledger which contains the overall balance of the Sales Ledger.

Deferred expenditure: Expenses incurred which do not apply to the current accounting period. Instead, they are debited to a 'Deferred expenditure' account in the **non-current assets** area of your **chart of accounts**. When they become current, they can then be transferred to the profit and loss account as normal.

Deferred Revenue aka. **Income in Advance:** Usually refers to money received for services which have not yet been delivered eg. memberships paid for a whole year.

Depreciation: The value of assets usually decreases as time goes by and they are used in the business. The amount or percentage it decreases by is called depreciation. This is normally calculated at the end of every accounting period at a rate which reflects an estimate of its useful life. It is an accounting adjustment only – no cash is involved. By writing down the asset each year, this reduction in value is charged as an expense in the Profit & Loss Account and in this way, tries to match the benefit to the business. It is therefore shown in both the profit & loss account and the **accumulated depreciation** is shown in the balance sheet. See **straight-line and reducing balance depreciation**.

Derivatives: Instruments, e.g. Options and future contracts, which derive their value from the underlying security, group of securities (e.g. Bonds, bills or currencies) or an index.

Direct Costs: Those costs that can be seen to specifically relate to a Cost Object.

Discussion and Analysis: This is usually seen in a financial report – typically the **Concise Annual Report.** The information disclosed has been derived from analysis and discussions held by the management. (It is presented for the benefit of shareholders).

Dividends: These are payments to the shareholders of a company. The majority of shareholders approve the amount of dividend to be paid every year. It is often paid in the form of interim and final dividends. A company does not have to pay a dividend and conversely, can pay a dividend even when it has made a loss – as long as it has sufficient retained profits/earnings.

Double-entry book-keeping: A system which accounts for every aspect of a transaction – where it came from and where it went to. This *from* and *to* aspect of a transaction (called crediting and debiting) is what the term double-entry means. Modern double-entry was first mentioned by G Cotrugli, and then expanded upon by L Paccioli in the 15th century.

DPS: Dividends per share (in cents).

Drawings: The money taken out of a business by its owner(s) for personal use. This is entirely different to wages paid to a business's employees or the wages or remuneration of a limited company's directors (see '**Wages**').

E

Earnings: Profit

EBIT: Earnings before interest and tax (Profit before any interest or taxes have been deducted). Often used as a measure of the operational management performance, since it measures them on things under their control, whereas operational managers are unlikely to be involved in determining the amount of debt their company has or the tax it pays.

EBITA: Earnings before interest, tax and amortisation (profit before any interest, taxes or **amortisation** have been deducted).

EBITDA: Earnings before interest, tax, depreciation and amortisation (profit before any interest, taxes,**depreciation** or **amortisation** have been deducted). Used in the same way as EBIT as a key measure of operational performance but it is also used as a surrogate for cash.

Encumbrance: A liability (e.g. a mortgage is an encumbrance on a property). Also, any money set aside (i.e. reserved) for any purpose.

Entry: Part of a transaction recorded in a journal or posted to a ledger.

EPS: Earnings per Share. This is calculated by dividing a company's net profit (less preference dividends (if any)) by the number of ordinary shares in issue.

EPS growth (EPSg) (%): Earnings per share growth measured fiscal year on fiscal year, and expressed in percentage terms.

Equity: This term is now used to describe the funding of the business which comes from shareholders – mainly represented by **Contributed Equity (Share Capital), Retained Profits** and **Reserves**. The term is also used for the value of the business to the owner of the business (which is the difference between the business's assets and liabilities).

Expenses: Goods or services purchased directly for the running of the business. This does not include goods bought for re-sale or any items of a capital nature (see Stock/Inventory and Non Current or Fixed Assets).

F

FIFO: First In First Out. A method of valuing stock/inventory.

Fiscal year: The term used for a business's accounting year. The period is usually twelve months which can begin during any month of the calendar year (e.g. 1st July to 30th June).

Fixed Assets – now reported as Non Current Assets: These consist of anything which a business owns or buys for use within the business and which it intends to keep for at least 12 months. They usually consist of major items like land, buildings, equipment and vehicles but can include smaller items like tools. (See **Depreciation**)

Fixed Cost: A fixed cost is one where the total cost does not change when there is a change in activity level. Examples include – rent, rates, insurance etc.

Fixtures & Fittings: This is a class of fixed asset/non current asset which includes office furniture, filing cabinets, display cases, warehouse shelving and the like.

Flash earnings: A news release issued by a company that shows its latest quarterly results.

Forecast: This is used in two ways. Firstly it is used to refer to a budget – e.g. Sales Forecast or Cash Flow Forecast. Secondly it is used to describe an estimate of a full years' results using actual figures to date plus budgeted numbers to the year end.

Franked Dividend: Dividends paid out of company profits on which the full corporate tax has been paid. Shareholders obtain a tax credit to offset against their personal income tax liability on the dividend.

Free Cash Flow: This represents the cash generated from operating activities less cash used for purchases of property, plant and equipment. Both of these numbers are shown on the Cash Flow Statement.

G

Gearing (Also Known As: leverage): The comparison of a company's long term fixed interest loans compared to its assets. In general two different methods are used: 1. Balance sheet gearing is calculated by dividing long term loans with the equity (or proprietor's net worth) or as a proportion of total financing. 2. Profit and Loss gearing: Fixed interest payments for the period divided by the profit for the period.

General Ledger: See **Nominal Ledger**.

Going Concern – Assumption that a business can remain solvent until the next reporting period. It is one of the fundamental accounting concepts underlying the preparations of financial statements. Accounts are prepared on a going concern basis with assets shown at their cost to the business. The alternative basis would be to prepare accounts using "break up "values.

Goods and Services Tax (GST – applies to many countries): GST, as it is usually called, is a sales tax which increases the price of goods. At the time of writing the Australian GST standard rate is 10%. GST is added to the price of goods so in the Australia, an item that sells at $10 will be priced $11 when 10% GST is added.

Goodwill: An **intangible asset**. It represents the premium paid in the acquisition of an entity over the fair value of its identifiable tangible and intangible Assets less Liabilities acquired.

Gross loss: See **Gross Profit.**

Gross margin: The difference between the selling price of a product or service and the cost of that product or service often shown as a percentage. E.g. if a product sold for 100 and cost 60 to buy or manufacture, the gross margin would be 40%. Gross margin can also be expressed on the total revenue and costs of producing that revenue as well as on an item by item basis.

Gross profit: Revenue/sales less **Cost of Sales /Cost of Goods Sold.** This is shown in the trading account, which is the term used to describe the first part of the Profit and Loss Account. If the costs exceed the revenue generated, then a **Gross Loss** is recorded.

Growth and Acquisition (G & A): Describes a way a company can grow. Growth means expanding through its normal operations, Acquisition means growth through buying up other companies.

H

Historical Cost: Assets, stock/inventory, raw materials etc. can be valued at what they originally cost (which is what the term 'historical cost' means), or what they would cost to replace at today's prices (see **Price change accounting**). Historical Cost is also an accounting principle requiring all financial statement items to be based on original cost.

Historical Budgeting: See **Incremental Budgeting**.

I

Impairment: An asset is impaired when its carrying amount exceeds its recoverable amount. Businesses are required to carry out an impairment test each year on assets shown in the Balance Sheet to ensure that their values are not overstated. This term is particularly applicable to Intangible Assets.

Income: Money received by a business from its commercial activities. See **'Revenue**'.

Income Statement: A statement listing the total incomes and total expenses incurred during a specific accounting period. (Also known as the **Profit and Loss Account**).

Incremental Budgeting: Using actual historical data as the basis for preparing the budget for the next budgeting period after applying an increment. Aslo known as Historical or Baseline Budgeting.

Indirect Costs: Often used as a term for Support Costs or Shared Costs. Indirect Costs cannot be clearly attributed to a Cost Object and require a basis of allocation under Absorption or Activity Based Costing.

Insolvent: A company is insolvent if it has insufficient funds (all of its assets) to pay its debts (all of its liabilities) as and when they fall due. If a company's liabilities are greater than its assets and it continues to trade, it is not only insolvent, but in Australia, is operating illegally and the Directors can be held personally liable for the company's debts.

Intangible assets: Assets of a non-physical or financial nature. An asset such as a brands, licenses, patents or **goodwill** are good examples. See **tangible assets**.

Interest Bearing Liabilities: Usually loans - can be current or non-current.

Inventory: This has 2 common meanings: Firstly it is now the term used in reporting **Stock** – Raw Materials, Work in Progress and Finished Goods. Secondly the term is used to describe a list as used in compiling an inventory of something e.g., **Fixed Assets/Non Current Assets** Inventory.

Invoice: A term describing an original document either issued by a business for the sale of goods on credit (a sales invoice) or received by the business for goods bought (a purchase invoice).

J

Journal(s): A book or set of books where your transactions are first entered.

Journal entries: A term used to describe the transactions recorded in a journal.

JV: Joint Venture - A structure where 2 or more organisations jointly own another company neither/none have a controlling interest.

K

No entries

L

Landed Costs: This is the total costs involved when importing goods. They include buying, shipping, insuring and associated taxes.

Ledger: A book in which entries posted from the journals are re-organised into accounts.

Leverage: See **Gearing**.

Liabilities: Liabilities represent all monies owed by the business**.** This includes bank overdrafts, loans taken out for the business and money owed by the business to its suppliers. Liabilities are shown on the Balance Sheet and normally consist of accounts which have a credit balance.

LIFO: Last In First Out. This is a method of valuing **stock/inventory.** Not currently allowed in Australia.

Long term liabilities now reported as Non Current Liabilities: These usually refer to long term loans (i.e. a loan/ part of a loan which is due for repayment in more than 12 months).

Loss: See **Net loss.**

LSL: Long Service Leave

M

Management accounting: Accounts and reports are tailor made for the use of the managers and directors of a business (in any form they see fit – there are no rules) as opposed to financial accounts which are prepared for reporting to shareholders, the Australian Taxation Office and any other parties not directly connected with the business. See **Cost accounting.**

Manufacturing account: An account used to show what it cost to produce the finished goods made by a manufacturing business.

Margin: A profit expressed as a percentage of sales. See **Gross Margin**. Net Profit Margin and EBIT are also commonly calculated and monitored.

Marginal Costing: A method of costing where **Variable Costs** are allocated to products or services to calculate each product or service's **Contribution** to total fixed costs. Unlike **absorption costing**, no attempt is made to allocate fixed costs back to each product or service.

Mark-Up: The amount by which the cost price is increased to set the sales price. Mark up is usually expressed as a percentage. So if goods costing $50 were marked up by 100%, then their sales price would be $100.

Market Capitalisation (or Market Cap): The total number of listed issued shares in a company, multiplied by the share price. A "quick and dirty" method of putting a value on a company.

Matching principle: A method of matching income and expenses to a certain period. So comparing income earned in a say 12 months, against the costs incurred in that same period, to calculate the profit or loss.

Maturity value: The (usually projected) value of an intangible asset on the date it becomes due.

Minority interest: A minority interest represents a minority of shares not held by the holding company of a subsidiary. It means that the subsidiary is not wholly owned by the holding company. The minority shareholdings are shown in the holding company accounts as **Other interests or Non Controlling Interests**.

N

Net loss: The value of expenses less sales assuming that the expenses are greater (i.e. if the profit and loss account shows a debit balance).

Net of Tax: The price less any tax. E.g. if you sold some goods for $22 inclusive of $2 GST, then the 'net of tax' price would be $20.

Net profit: The value of sales less expenses assuming that the sales are greater (i.e. if the profit and loss account shows a credit balance).

Net worth: See **Equity**.

Nominal Accounts: A set of accounts held in the nominal ledger. They are termed 'nominal' because they don't usually relate to an individual person. The accounts which make up a Profit and Loss account are nominal accounts (as is the Profit and Loss account itself), whereas an account opened for a specific customer is usually held in a subsidiary ledger (the **sales ledger** in this case) and these are referred to as **personal** accounts.

Nominal Ledger: A ledger which holds all the **nominal accounts** of a business. Where the business uses a subsidiary ledger like the sales ledger to hold customer details, the nominal ledger will usually include a control account to show the total balance of the subsidiary ledger (a control account can be termed ‘nominal’ because it doesn’t relate to a specific person).

Non Controlling Interests: See **Minority Interest**.

NOPAT: Net Operating Profit After Tax - sometimes shortened to Net Profit. This is the final profit after all expenses, interest and tax have been deducted. It is therefore the amount that the shareholders have earned. Often also referred to as 'Net income'.

NTA: Net tangible asset backing per share (in cents). The theoretical value of net assets attributable to each ordinary share on issue, calculated by dividing shareholders’ funds (net of minority interests, intangible assets and preference shares) by the number of ordinary shares on issue.

O

Opening the books: Every time a business closes the books for a year, it opens a new set. The new set of books will be empty; therefore the balances from the last balance sheet must be copied into them (via **journal** entries) so that the business is ready to start the new year.

Operating result: Revenue or Income less Expenses i.e. Profit or Loss.

Opex: Shortened form of Operating Expenditure - similar to Operating Costs/Expenses/Overheads and are charged to the Profit and Loss Account in the period they are incurred.

Ordinary Share: This is a type of share issued by a limited company. It carries the highest risk but usually attracts the highest rewards. Most ordinary shares carry voting rights.

Overheads: These are the costs involved in running a business. They consist entirely of expense accounts (e.g. rent, insurance, petrol, staff wages etc.).

P

Paid-up Share capital now reported as Contributed Equity: The value of issued shares which have been paid for. See **Called-up Share capital** or **Contributed Equity.**

P.A.Y.G (Australia only): ‘Pay as you Go’. This is the name given to the income tax system where companies and employees pay their tax instalments on account during the year, based on estimates calculated by the ATO. When they submit their assessments, then these payments are deducted from the final tax figure.

PE or P/E ratio: An equation which gives you a very rough estimate as to how much confidence there is in a company’s shares (the higher it is the more confidence). The equation is: **current share price** multiplied by **earnings** and divided by the **number of shares**. ‘Earnings’ means the last published net profit of the company. P/E ratio Example: Company ‘A’ has an **Earnings per share** (EPS) of $1. The current share price is $10. This gives a P/E ratio of 10 (current share price is 10 times the EPS).

Perpetual inventory: A Perpetual Inventory is one whose balance is updated after each and every transaction, as in a computerised inventory system. See **Inventory**.

Personal Accounts: These are the accounts of a business's customers and suppliers. They are usually held in the Sales and Purchase Ledgers.

Petty Cash: A small amount of money held in reserve (normally used to purchase items of small value where a cheque or other form of payment is not suitable).

Petty Cash Slip: A document used to record petty cash payments where an original receipt was not obtained (sometimes called a petty cash voucher).

Point of Sale (POS): The place where a sale of goods takes place, e.g. a shop counter. Most cash registers have computerised POS Systems.

Posting: This is the copying of entries from the journals to the ledgers.

Preference Shares: This is a type of share issued by a limited company. It carries a medium risk but has the advantage over ordinary shares in that preference shareholders get the first slice of the dividend 'pie' (but usually at a fixed rate).

Prepayments or prepaid expenses: An expense, other than inventory, with benefits that extend into the future, paid in advance. Eg. rent, insurance.

Price change accounting: Accounting for the value of assets, stock, raw materials etc. by their current market value instead of the more traditional **Historic Cost**.

Profit: See **Gross profit**, **Net profit**, and **Profit and Loss Account**.

Profit and Loss Account: An account made up of revenue and expense accounts which shows the current profit or loss of a business (i.e. whether a business has earned more than it has spent in the current year). In Financial Reporting, this is now called the **Income Statement**.

Profit margin: The percentage difference between the costs of a product and the price you sell it for. E.g. if a product costs you $10 to buy and you sell it for $20, then you have a $10 profit margin which represents 50% of the sales price i.e. the profit margin% is 50%.

Pro-forma accounts (pro-forma financial statements): A set of accounts prepared before the accounts have been officially audited. Often done for internal purposes or to brief shareholders or the press.

Pro-forma invoice: An invoice sent that requires payment before any goods or services have been despatched.

Provisions: Liabilities set up to account for expected future payments (e.g. where a business is expecting a bill, but hasn't yet received it). Provisions are usually estimated and they can be current or non current. One of the most common forms of provisions are those for annual leave not taken and also long service leave.

Purchase Invoice: See **Invoice**.

Purchase Ledger: A subsidiary ledger which holds the accounts of a business's suppliers. A single control account is held in the **nominal** ledger which shows the total balance of all the accounts in the purchase ledger.

Q

Quick Ratio: Also known as the **Acid test ratio.** This looks at liquidity, i.e., a company's ability to pay its bills. The Quick ratio compares the current assets that can be turned into cash quickest – cash and receivables, less payables.

R

Raw Materials: This refers to the materials bought by a manufacturing business in order to manufacture its products.

Realisation principle: The principle whereby the value of an asset can only be determined when it is sold or otherwise disposed of, i.e. its 'real' (or realised) value.

Rebate: If you pay for a service, then cancel it; you may receive a 'rebate'. That is, you may be refunded some of the money you paid for the service. (E.g. if you cancel a 1 year insurance policy after 3 months, you may get a rebate for the remaining 9 months). Another example refers to supplier rebates where a company receives a rebate based on the volume of purchases made from that supplier.

Receipt: A term typically used to describe confirmation of a payment – if you buy some petrol you will normally ask for a receipt to prove that the money was spent legitimately.

Reconciling: The procedure of checking entries made in a business's books with those on a statement sent by a third person (e.g. checking a bank statement against your own records).

Reducing balance method of depreciation: The method of deprecating assets whereby the chosen percentage is applied to the remaining balance after applying the previous year's depreciation. For example if an asset costing $100k is depreciated at 10% on a reducing balance basis, the charge in year 1 would be $10K and in year 2 the depreciation charge would be $9K – 10% of $90k. This method means that more depreciation is deducted in early years and is seen to therefore more accurately reflect the actual fall in value of the asset.

Refund: If you return some goods you have just bought (for whatever reason), the company you bought them from may give you your money back. This is called a 'refund'.

Reserves: This term is used in 2 ways. Firstly it has been used to describe **retained profits or retained earnings**. i.e. .all the profits that the company has made since it started trading. Secondly, the term is used to describe profits on items which have not been reported through the Profit & Loss Account. The most common of these is the **Revaluation Reserve**.

Retail: A term usually applied to a shop which re-sells other people's goods. This type of business will require a trading account as well as a profit and loss account.

Retained profits or earnings: This is the amount of money held in a business after its owner(s) have taken their share of the profits. It may be for one year or the total of all the profits retained in the business since it commenced business.

Retainer: A sum of money paid in order to ensure a person or company is available when required.

Retention ratio: The proportion of the profits retained in a business after all the expenses (usually including tax and interest) are taken into account. The algorithm is retained profits divided by profits available for ordinary shareholders (or available for the proprietor/partners in the case of unincorporated companies).

Return: In accounting terms this is usually a profit figure**.**

Revaluation Reserve: The total of surpluses less deficits which have arisen as a result of the revaluation of non current assets. The non current asset will be stated in the Balance Sheet at the revalued amount and the difference between that and the cost or carrying value of the asset will be shown in the Revaluation Reserve.

Revenue: The sales and any other earned income of a business (e.g. interest earned from money on deposit).

Revenue Drivers: These are factors that influence or contribute to the revenue generated by the business. There are 4 variables which drive Revenue - C x F x T x P where Revenue = (Number of Customers) x (Frequency of Purchase) x (Average Transaction Size) x (Price).

Run Rate: A forecast for the year based on the current year to date figures. If a company's 1st quarter profits were, say, $25m, they may announce that the run rate for the year is $100m.

S

Sales: Income received from selling goods or a service. See **Revenue**.

Sales Invoice: See **Invoice**.

Sales Ledger: A subsidiary ledger which holds the accounts of a business's customers. A control account is held in the **nominal** ledger (usually called a debtors' control account) which shows the total balance of all the accounts in the sales ledger.

Self Assessment (Australia only): The idea of self assessment is to allow companies and individuals to calculate their own income tax.

Self-balancing ledgers: A system which makes use of control accounts so that each ledger will balance on its own. A control account in a subsidiary ledger will be mirrored with a control account in the **nominal** ledger.

Self-employed: The owner (or partner) of a business who is legally liable for all the debts of the business (i.e. the owner(s) of a non-limited company).

Selling, General & Administrative expense (SG & A): The expenses involved in running a business.

Service: A term usually applied to a business which sells a service rather than manufactures or sells goods (e.g. an architect or a window cleaner).

Shareholders: The owners of a limited company or corporation.

Share premium: The extra paid above the face value of a share. Example: if a company issues its shares at $10 each, and later on you buy 1 share on the open market at $12, you will be paying a share premium of $2.

Shares: These are documents issued by a company to its owners (the shareholders) which state how many shares in the company each shareholder has bought and what percentage of the company the shareholder owns. Shares can also be called ‘Stock’.

Shares issued (a.k.a. Shares outstanding): The number of shares a company has issued to shareholders. This is also referred to as **Contributed Equity**.

Simple interest: Interest applied to the original sum invested (as opposed to **compound interest**). E.g. 1000 invested over two years at 10% per year simple interest will yield a gross total of 1200 at the end of the period (10% of 1000=100 per year).

Sinking fund: An account set up to reduce another account to zero over time (using the principles of **amortisation** or **straight line depreciation**). Once the sinking fund reaches the same value as the other account, both can be removed from the balance sheet.

SME: Small and Medium Enterprises (i.e. small and medium size businesses). The distinction between what is ‘small’ and what is ‘medium’ varies depending on where you are and who you talk to.

Sole trader: See **Sole-proprietor**.

Sole-proprietor: The self-employed owner of a business (see **Self-employed**).

Source document: An original invoice, bill or receipt.

Statement of Cash Flows: A statement listing all the cash receipts and cash payments – including asset purchases – made during a specific time period. (Also known as the **Cash Flow Statement**).

Statement of Financial Position: Another term for **Balance Sheet**.

Stock: This can refer to the shares of a limited company (see **Shares**) or goods manufactured or bought for re-sale by a business (see **Inventory**).

Stockholders: See **Shareholders**.

Stock Taking: Physically checking a business’s stock for total quantities and value.

Stock valuation: Valuing a stock of goods bought for manufacturing or re-sale.

Straight-line depreciation: Depreciating something by the same (i.e. fixed) amount every year rather than as a percentage of its previous value. Example: a vehicle initially costs $10,000. If you depreciate it at a rate of $2000 a year, it will depreciate to zero in exactly 5 years. See **Depreciation**.

Subordinated debt: If a company is liquidated (i.e. becomes **insolvent**), the secured creditors are paid first. If any money is left, the unsecured creditors are then paid. The amount of money owed to the unsecured creditors is termed the 'subordinated debt' of the company.

Suspense Account: A temporary account used to force a trial balance to balance if there is only a small discrepancy (or if an account's balance is simply wrong, and you don't know why). A typical example would be a small error in petty cash. In this case a transfer would be made to a suspense account to balance the cash account. Once the person knows what happened to the money, a transfer entry will be made in the journal to credit or debit the suspense account back to zero and debit or credit the correct account.

T

T Account: A particular method of displaying an account where the debits and associated information are shown on the left, and credits and associated information on the right.

Tangible assets: Assets of a physical nature. Examples include buildings, motor vehicles, plant and equipment, fixtures and fittings. See **Intangible assets**.

Total Absorption Costing: See **Absorption Costing**.

Trading account: This is an account which shows the gross profit or loss of a manufacturing or retail business, i.e. sales less the cost of goods sold.

Transaction: Two or more entries made in a **journal** which when looked at together reflect an original document such as a sales invoice or purchase receipt.

Trial Balance: A statement showing all the accounts used in a business and their balances.

Turnover: The income of a business over a period of time (usually a year). See **Revenue.**

U

Undeposited Funds Account: An account used to show the current total of money received (i.e. not yet banked or spent). The 'funds' can include money, cheques, credit card payments, bankers' drafts etc. This type of account is also commonly referred to as a 'cash in hand' account.

V

Variance: The difference between actual results and budget. These are 3 types of variance - price, volume and timing. The latter (where there is a mismatch between when something is budgeted to happen and when it actually occurs e.g. if a project is delayed) is a temporary variance and will therefore reverse and should have no overall impact on the full year result.

Variable Cost: A cost that varies in line with volume/activity levels**.** Variable costs usually include raw materials in a production process or sales commissions.

W

Wages: Payments made to the employees of a business for their work on behalf of the business. These are classed as expense items and must not be confused with 'drawings' taken by sole-proprietors and partnerships (see **Drawings**).

Work in Progress: The value of partly finished (i.e. partly manufactured) goods.

Working Capital: This is the money required to run the business on a day to day basis. At any one time it is represented by the difference between current assets and current liabilities i.e. cash, receivables, inventory less payables**.** Since this money is effectively dead money, good working capital management requires that businesses try to minimise their working capital.

Write-off: Depreciating an asset to zero in one go.

X

No entries

Y

Yield: The annual return on an investment (bond, shares, property) expressed as a percentage.

Z

Zero Based Account (ZBA): Usually applied to a personal account (checking) where the balance is kept as close to zero as possible by transferring money between that account and, say, a deposit account.

Zero Based Budget (ZBB): Creating a budget without relying on historical data i.e. starting at zero, with a clean sheet.

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