Professional English for Masters of Economics

Unit 11 FINANCIAL ACCOUNTING

11.1 Getting started

Accounting has been defined as "the process or art of recording and verifying accounts". This in itself is not very informative. More helpful would be to review accountancy in much broader terms as a database of information about the activities of an organization which is expressed in monetary terms. It must answer three important questions:

- What information is needed?
- Who is the information for?
- What form should the information take?

The information required is concerned with profits, growth, liquidity and solvency which is needed in order to help effective decision –making. The role of the accountant is to record and account for transactions over a period of time and to communicate or report the resulting information.

Who requires the financial information? Two groups, one internal and one external, are interested in the performance of an organization. The internal group is comprised of the owners, managers and employees. Owners, both existing and potential, want to know how their investment has performed and what its future prospects are. Managers require financial information in order to review the success of past decisions and to help formulate and control future plans. Finally, the employees are interested with respect to job security and the company's ability to meet pay claims. The external group includes the government and creditors. The government requires financial information to verify tax liabilities and creditors are interested in order to assess the creditworthiness of the organization.

With all these needs to satisfy, what form should the information take? The volume and detail of business information is so immense that whatever form is chosen it must be condensed. In this unit we will look at the three principal statements: the Balance Sheet, the Income Statement or Profit and Loss Account and the Funds Flow Statement.

Discuss the following points.

1. Accountancy has two distinct branches: Financial Accounting and Management Accounts. Which one accounts for the past?
2. Which one aids the planning and control of present and future events?

11.2 Look through the following vocabulary notes which will help you understand the text and discuss the topic.

financial accounting	финансовый учет
to verify	сверять, сличать
accountancy	бухгалтерская отчетность, делопроизводство
an accountant	бухгалтер с управленческими функциями
accounting	бухгалтерский учет
accountancy profession	бухгалтерское дело, учетные работники, бухгалтеры
bookkeeping	бухгалтерия, счетоводство
an account	счет, отчет
to account for smth	отчитываться о ч/л
liquidity	ликвидность
solvency	платежеспособность
to communicate information	сообщать информацию
to report information	предоставлять отчет, докладывать
prospects	перспективы
to meet pay claims	удовлетворять требования о выплатах
tax liabilities	налоговые обязательства
liabilities	обязательства
current/short-term liabilities	текущие/краткосрочные обязательства
long-term liabilities	долгосрочные обязательства
assets	активы
current/short-term assets	краткосрочные/текущие активы
fixed assets	долгосрочные/необоротные активы
(in)tangible assets	(не)материальные активы
to assess	оценивать
assessment	оценка

creditworthiness	кредитоспособность
condensed	сжато выраженный
the Balance Sheet	Балансовый отчет
the Income Statement or Profit and Loss Account	Отчет о прибылях и убытках
the Funds Flow Statement	Отчет о движении средств
the Cash Flow Statement	Отчет о движении наличных средств
the Directors' Report	Отчет совета директоров
the Chairman's Statement	Отчет председателя
the Auditor's Report	Аудиторский отчет
the Annual Report	Годовой отчет
Notes to the Accounts	примечания/пояснения к отчетности
Statistical Tables	Статистические таблицы
the Added Value Statement	Отчет о добавленной стоимости
accounting concepts	учетные принципы
accounting conventions	методы и процедуры учетной практики
an assumption	допущение, предпосылка
going concern	принцип непрерывности деятельности предприятия
consistency	принцип постоянства (применения учетных методов)
accruals	начисления
matching concept	принцип соответствия
prudence and conservatism	консерватизм
realization principle	принцип реализации
revenue	выручка, доход
cost	стоимость, себестоимость
rules of thumb	«на глазок», из опыта, приближенно
objectivity	объективность
separate entity	самостоятельная хозяйственная единица
a legal person	юридическое лицо
money measurement	принцип денежного выражения
historic cost	первоначальная стоимость

to be valued at cost	оцениваться по себестоимости
to fall/decrease in value	понизиться в стоимости
depreciated/written down in value	списанный, обесцененный
double-entry	двойная запись
an entry	проводка, запись
a posting	разноска хозяйственных операции по счетам бухгалтерского учета
a transaction	хозяйственная операция
the code of practice	кодекс профессиональной этики
professional accountancy bodies	профессиональные бухгалтерские организации
a ‘true and fair view’	достоверное и объективное представление
performance	результаты деятельности
to own	владеть
to owe	быть должным
Shareholders’ funds/capital	акционерный капитал
limited liability companies	
Share capital	складочный капитал
Ordinary Share Capital	складочный капитал в форме обыкновенных акций
part ownership	
Authorized Share Capital	объявленный уставный капитал, разрешенный к выпуску акционерный капитал
Issued Share Capital	выпущенный акционерный капитал, выпущенные акции
equity	собственный, чистый капитал
reserves	фонды, резервы
share premiums	надбавка к номинальной стоимости акций
revaluations	переоценка
retained profits	нераспределенная прибыль
to be due	подлежать
debentures	долговые обязательства
the balance sheet date	дата составления Баланса
bank overdraft	банковский овердрафт

dividends payable	дивиденды к оплате
goodwill	гудвил, цена фирмы, деловая репутация компании
vehicles	транспортные средства
stocks/inventories	товарно-материальные запасы
debtors/accounts receivable	дебиторская задолженность, счета к получению
creditors/accounts payable	кредиторская задолженность, счета к оплате
cash	денежные средства
the trading account	торговое сальдо
the profit and loss account	отчет о прибылях и убытках
the appropriation account	счет распределения прибылей
sales revenue/turnover	выручка от продаж
cost of goods sold	себестоимость реализованной продукции
direct labor	прямые затраты на оплату труда производственных рабочих
production overheads	производственные накладные расходы
gross profit	брутто-прибыль, валовая прибыль
trading/operating profit	операционная прибыль
selling expenses	расходы по реализации товаров
administrative costs	административные расходы
profit before tax	прибыль без вычета налога
less	за вычетом
after-tax profit	прибыль за вычетом налога
net profit	чистая прибыль
ordinary dividends	дивиденд по обыкновенным акциям
solvent in the short term	платежеспособный в краткосрочном периоде
commitments	
anticipated outflows	ожидаемый приток наличности
anticipated inflows	ожидаемый отток наличности
working capital	оборотный капитал
fixtures and fittings	принадлежности и инвентарь
an invoice	счет-фактура, накладная

a pro forma invoice	ориентировочный счет-фактура
a fiscal year	фискальный/налоговый год
an accounting period	отчетный период
a nominal ledger	номинальный регистр
a journal	учетный регистр
a trial balance	пробный баланс
depreciation/amortization	списание, износ/амортизационное списание
stock valuation	инвентарная оценка, оценка запасов
work-in-progress	незавершенное производство
finished goods	готовые товары

11.3 Reading

The Basics of Financial Accounting

The production of financial accounts is largely governed by three sets of influences: accounting concepts, accounting conventions and legislation. These have been developed over the years so that different accountants producing accounts for different organizations in various activities can do so using similar methods.

Accounting concepts There are four basic assumptions which underline the production of a set of accounts.

- *Going concern*: the organization is assumed to be an enterprise that will 'continue in business for the forseeable future".
- *Consistency*: this means adopting the same procedure every time for recording and measuring items.
- *Accruals or matching concept*: this concept recognizes revenues and costs as they are earned or incurred rather than as money is received or paid.
- *Prudence and conservatism*: this concept is designed to balance the natural optimism of the businessman!

Accounting conventions Many conventions have been adopted over the years as tried and trusted 'rules of thumb'. Five principal ones are:

- *Objectivity*: as far as possible accounts should be based on facts which are measurable and can be independently verified.
- *Separate entity*: the company is recognized as a legal 'person' in its own right entirely separate from its owners and managers.

- *Money measurement*: all company assets and liabilities are measured in a common unit, money.
- *Historic cost*: all items are valued at cost. Where items fall in value through use they are depreciated or written down in value.
- *Double-entry*: all transactions involve two sides: giving and receiving.

Some concepts and conventions are so fundamental that they have been incorporated into legislation and/or the code of practice of the professional accountancy bodies. All these concepts, conventions and legislation are concerned with ensuring that the information statements present a 'TRUE AND FAIR VIEW' of the organization and its performance.

The Balance Sheet is a statement of the financial position of an organization at a given date. It shows the organization's resources on that date in terms of what it owns and what it owes, i.e. its assets and liabilities and shareholders' funds. Money and resources have been provided by the owners (shareholders) and creditors which have been invested in various assets. The organization is responsible for repayment or safekeeping of these funds. The money owed to creditors is known as Liabilities and that of the owners as Shareholders' Funds.

In simple terms the Balance Sheet is made up of two elements, a source of funds and a use of funds. The first is normally divided into two sections, Shareholders' Funds and Liabilities, while the latter details the assets acquired. This can be summarized in Table 1 using traditional horizontal format.

Each section can be further divided to provide more detail.

Shareholders' Funds can take many forms, the most common of which in limited liability companies are:

- *Ordinary Share Capital*: represents funds invested in the company in return for part ownership. Often referred to as "equity". The total number of shares allowed to be issued is called the *Authorized Share Capital* which may differ from the number actually sold, the *Issued Share Capital*.
- *Reserves*: these can have three forms**:** *share premiums, revaluations and retained profits.* Share premiums occur when a company issues shares which are sold for a price higher than their nominal value.

Revaluations take account of assets (usually land and buildings) whose current value is greater than the historic cost because of inflation. Retained profits are those profits which the company directors have decided not to distribute as dividends but to retain in order to finance future operations.

MAIN ELEMENTS IN A BALANCE SHEET

SOURCE OF FUNDS	**USE OF FUNDS**
SHAREHOLDERS' FUNDS	**ASSETS** **:FIXED** **:CURRENT**
LIABILITIES **: LONG TERM** **:CURRENT**	

Table 1 Horizontal format for balance sheet

Liabilities represent any monetary amount owed by the organization to another party. *Long-term liabilities* are borrowings which are not due to be repaid for at least 12 months. These comprise long-term bank loans and debentures, which are borrowings from the public.

Current liabilities are debts which require payment within 12 months of the balance sheet date. They comprise creditors, bank overdraft, taxation and dividends payable.

Assets are items owned by the business and can be of two forms: *tangible* and *intangible*. Intangibles include management skills or goodwill and as such are not normally shown in the Balance Sheet. The tangible assets are broadly divided into fixed and current assets.

Fixed Assets are long-term resources of the business which are designated to be used for more than one accounting period. They include such items as property, plant and machinery, office equipment and vehicles.

Current Assets comprise short-term resources which will be used up or change their form during the next 12 months. The constituent parts will be stocks, debtors and cash.

The Profit and Loss Statement shows revenues and expenses and the resulting profit or loss for a given period of time (normally a year). The overall statement can be divided into three parts: the *trading account, the profit and loss account and the appropriation account*.

TRADING ACCOUNT (pounds sterling)				
SALES REVENUE				**A**
LESS Cost of Goods Sold				
Materials	**B**			
Direct Labor	**C**			
Production overheads	**D**			
	B+C+B		**=**	**E**
GROSS PROFIT		**A-E**	**=**	**F**

Table 2 Trading account

The trading account details the sales revenue of the period less operating expenses to give a trading or operating profit or gross profit.

PROFIT AND LOSS ACCOUNT (pounds sterling)			
GROSS PROFIT			**A**
LESS Selling expenses	**B**		
Administrative costs	**C**		
	B+C	**=**	**D**
TRADING (OPERATING PROFIT)	**A-D**	**=**	**E**
ADD: NON-OPERATING INCOME			**F**
TOTAL PROFIT BEFORE INTEREST AND TAX	**E+F**	**=**	**G**
LESS: interest			**H**
PROFIT BEFORE TAX	**G-H**	**=**	**I**

Table 3 Profit and loss account

The profit and loss account starts with gross profit, deducts overhead expenditure (selling and administrative expenses) to arrive at an operating profit and then adds any income from non-operating sources to arrive at a total profit figure. From this total is deducted interest. The final figure is the profit before taxation.

The appropriation account shows how Profit is distributed or "appropriated". Some of it will be appropriated by the government as taxation. Part of the remaining after-tax profit will be distributed to shareholders in the form of dividends.

APPROPRIATION ACCOUNT (pounds sterling)

PROFIT BEFORE TAX			**A**
LESS TAX			**B**
PROFIT AFTER TAX	**A-B**	=	**C**
LESS ORDINARY DIVIDENDS			**D**
RETAINED PROFIT (LOSS)	**C-D**	=	**E**

Table 4 Appropriation account

The balance remaining is retained in the business to help finance future operations. It is added to Shareholders' Funds in the Balance Sheet under section Reserves.

Funds Flow Statement The main long-term objective of a business is to make a profit but in order to do this it must remain solvent in the short-term. The business must possess adequate liquid funds in order to finance its current operations. If a firm does not possess sufficient funds to meet its short-term commitments it can be forced to close. It is vital for a firm to keep a close control of the flow of funds in a period so that it ensures the anticipated outflows are adequately covered by anticipated inflows. The Funds Flow Statement details from where the sources of funds were obtained and how they were used or applied. The main sources of funds are:

- net profit
- issue of new shares

- raising of long-term debt or loans
- sale of fixed assets or investments

The main application or use of funds are:

- purchase of new fixed assets
- payment of dividends
- payments of taxes
- repayments of debt
- covering operating losses

The total sources of funds less the total uses of funds will give the net increase or decrease in funds during the year and represents the overall change in working capital such as stock, debtors, trade creditors and cash.

Cash Flow Statements From March 1992, public companies have been required by a Financial Reporting Standard to present a Cash Flow Statement instead of a Source and Application of Funds Statement. This places far greater emphasis on cash inflows or outflows in an accounting period.

11.4 Comprehension

11.4.1 Answer the questions using the active vocabulary and Unit 8 Glossary.

1. What is the production of financial accounts largely governed by?
2. What are the accounting concepts?
3. What are the accounting conventions?
4. What are all these concepts, conventions and legislation concerned with?
5. What three basic financial statements do you know?
6. What does the Balance Sheet describe?
7. How is the accounting equation typified in the Balance Sheet?
8. What the basic elements of the Balance Sheet?
9. What are the most common forms the Shareholders’ Funds can take?
10. What do reserves consist of?
11. What is meant by liabilities? Current liabilities? Short-term liabilities?

12. What is meant by assets? Tangible assets? Intangible assets? Current assets and fixed assets?
13. What does The Profit and Loss Statement show?
14. What parts can it be divided into?
15. Compare all terms meaning ‘profit’ used in these accounts.
16. Why is it vital for a firm to keep a close control of the flow of funds in a period?
17. What are the main sources of funds shown on the Funds Flow Statement?
18. What is the main application or use of funds?
19. How can the overall change in working capital be estimated?
20. What is the difference between the Cash Flow Statement and the Funds Flow Statement?
21. What can happen to a firm if it does not possess sufficient funds to meet its short-term commitments?
22. Why should accountants follow the principle of Prudence and conservatism?

11.4.2 Mark these statements T(true) or F(false) according to the information in the Text and Unit 11 Glossary. If they are false say why.

1. An account is a section in a ledger devoted to a single aspect of a business.
2. Assets represent what a business owes or is due.
3. Liabilities represent what a business owns or is due.
4. Assets are the uses of funds.
5. Liabilities are the sources of funds.
6. Accounting concepts are the same as accounting conventions.
7. The Balance Sheet shows revenues and expenses and the resulting profit or loss for a given period of time.
8. The Balance Sheet is a snapshot of the company’s financial position on a certain date.
9. Current Assets comprise short-term resources which will be used up or change their form during the period of more than 12 months.

10. Intangibles include management skills or goodwill and as such are normally shown in the Balance Sheet.
11. The profit and Loss statement is a summary of all the accounts of a business.
12. Overdraft is the withdrawal of funds in excess of one's present balance.
13. The Cash Flow Statement is a report which shows the flow of money in and out of the business over a period of time.
14. Matching means adopting the same procedure every time for recording and measuring items.
15. An entry is part of a transaction recorded in a journal or posted to a ledger.
16. Gross profit is the balance of the trading account assuming it has a debit balance.
17. An invoice is an original document either issued by a business for the sale of goods on credit or received by the business for goods bought.
18. Money measurement means that all company assets and liabilities are measured in a common unit, money.
19. Profit is the excess of expenses over revenue.
20. A share premium is the extra paid above the face value of a share.

11.5 Language practice

11.5.1 Match the English terms in the left-hand column with the definition in the right-hand column.

1	Account	A	A report which shows the flow of money in and out of the business over a period of time.
2	Invoice	B	A column in a journal or ledger to record the 'To' side of a transaction
3	Assets	C	A column in a journal or ledger to record the 'From' side of a transaction.
4	Matching principle	D	This is a class of fixed asset which includes office furniture, filing cabinets, display cases, warehouse shelving and the like.

5	Double-entry bookkeeping	E	A method of analyzing the sales and expenses which make up those sales to a particular period.
6	Overheads	F	A section in a ledger devoted to a single aspect of a business.
7	Cash flow statement	G	Assets of a non-physical or financial nature. An asset such as a loan or an endowment policy are good examples.
8	Fiscal year	H	An account which shows the gross profit or loss of a manufacturing or retail business, i.e. sales less the cost of sales.
9	Realization principle	I	A system which accounts for every aspect of a transaction - where it came from and where it went to.
10	Current liabilities	J	An amount of money put into the business (often by way of a loan) as opposed to money earned by the business.
11	Fixtures and fittings	K	A term describing an original document either issued by a business for the sale of goods on credit or received by the business for goods bought.
12	Capital	L	The balance of the trading account assuming it has a credit balance.
13	Debit	M	These are the costs involved in running a business.
14	Trading account	N	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 April 2001 to 31st March 2002).
15	Intangible assets	O	They represent what a business owns or is due.
16	Credit	P	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 realized) value.
17	Gross profit	Q	Debts which require payment within 12 months of the balance sheet date. They comprise creditors, bank overdraft, taxation and dividends payable.

11.5.2 Complete the following texts using the suitable words or phrases from the box.

Text 1

A	income	E	legal liability
B	debtors	F	stated
C	taxes	G	cash
D	accounting	H	periods

Revenue

Definition: Revenue is the total exchange value of the goods or services of a business which have been transferred to a customer in return for _____(1)_____ or some other asset, e.g. _____(2)_____. The following important points need to be known about revenue:

- The “Realization Concept” in _____(3)_____ recognizes a sale on acceptance of _____(4)_____ for payment by the buyer. Revenue can be in the form, therefore, of either cash payments or amounts owing (debtors).
- Revenue is not the same as receipts. Revenue refers to ____(5)____ earned in that financial period, whereas receipts may include earnings from other ____(6)____.
- Revenue is always ____(7)____ exclusive of any _____(8)_____, e.g. Value Added Tax.

Text 2

A	deducted	E	similar
B	include	F	states
C	revenue	G	associated
D	accounting period	H	against

Expenses

These represent the amounts charged ____(1)____ profit in respect of goods and services consumed during an ____(2)____. The 'matching principle' or 'accrual concept' ____(3)____ that from revenues of a period must be ____(4)____ all expenses of the benefits used in producing that revenue. In a ____(5)____ way to ____(6)____ and receipts, expenses are not the same as payments. Expenses refer only to those costs ____(7)____ with the goods or services sold in the period, whereas payments may ____(8)____ items from previous periods, or advanced expenditure for costs to be incurred in later periods.

Text 3

A	overhead	E	period
B	administrative	F	direct labor
C	costs	G	accounting
D	referring	H	identified

Costs

Direct or product costs are those ____(1)____ which can be accurately attributed to and identified with specific goods, e.g. raw materials, ____(2)____ and some production overheads. Indirect or period costs are those ____(3)____ expenses which are not easily ____(4)____ with a given output but refer to a ____(5)____ of time, e.g. selling and ____(6)____ costs. Product and period costs ____(7)____ to items sold in an ____(8)____ period are known as revenue expenditure.

11.5.3 Complete the text. Replace the Russian words and phrases by the English equivalents.

Laws, Rules and Standards

В большинстве continental European countries, ***и в Японии***, ***существуют законы*** relating to ***бухгалтерскому учету*** established ***правительством***. In the US, ***компании чьи акции*** are traded on public ***фондовых биржах*** have to follow rules ***установленные*** by the Securities and Exchange Commission (SEC), a ***правительственным органом***. In Britain, the rules, ***которые называются стандартами***, have been established by ***независимыми организациями*** such as the Accounting Standards Board (ASB), and by the ***учетными работниками*** itself. Companies are expected to apply ***или использовать эти стандарты*** in their ***годовых отчетах*** in order to ***дать достоверное и объективное представление***. Companies ***в большинстве англо-говорящих стран*** are largely ***финансируются акционерами***, both individuals and ***финансовыми институтами***. In these countries, the ***финансовые отчеты*** are prepared ***для акционеров***. ***Однако***, in many continental European countries ***фирмы*** are largely funded by ***банками***, so ***бухучет и финансовые отчеты*** are prepared ***для кредиторов*** and the tax authorities.

11.5.4 Text for discussion.

a. Look up the dictionary or Unit 11 Glossary for the meaning and pronunciation of the following words and word-combinations and use them to discuss the problems outlined in the text.

An Annual Report; A Directors’ Report; commentary; envisaged; board of directors; A Chairman’s Statement; An Auditor’s Report; a ‘true and fair view’; Notes to the Accounts; Statistical Tables; Added Value Statement.

b. Briefly scan the text and outline the list of major points.

c. Read the text more carefully and comment on the following items:

- the necessity of preparing The Annual Report by private limited companies, public limited companies in the UK and corporations in the USA (See Unit 1 Glossary of Professional Financial English)

- the importance of different reports and statements within the Annual Report;
- the reasons for which the Annual Report should contain An Auditor's Report.

Additional Statements

As well as the Balance Sheet, the Income Statement and the Funds Flow or Cash Flow statement an annual report to shareholders should also contain:

- *A Directors' Report*: a short written statement providing a commentary on the company's current position and any important changes envisaged in the near future. It will also include the recommended dividend together with any changes in the board of directors.
- *A Chairman's Statement*: a broader outlook at factors affecting the company in the past, present and future. It may include items such as political events which are likely to have an impact on company affairs.
- *An Auditor's Report*: this is required by law and will declare if the accounts have been prepared according to accounting practice and whether they give a 'true and fair view' of the company's financial position.
- *Notes to the Accounts*: a more detailed explanation of certain items in the accounts such as changes in fixed assets, shareholders' funds or long-term liabilities.
- *Statistical Tables*: a summary of the main accounting information over the past five or ten years.

In addition, the report might contain an *Added Value Statement*, which is an alternative method of showing the wealth created by the business.

11.6 Render the passage in English using the English equivalents of the italicized phrases given in Russian. Express the main idea of the passage in one sentence.

Необоротные Активы

Активы компании обычно делятся на текущие активы, такие как денежные средства и товарно-материальные запасы, которые будут использованы или *конвертированы в* **(converted into)** денежные средства *менее чем через* **(in less than)** год, и необоротные активы, такие как *здания и оборудование* **(buildings and equipment)**, которые будут продолжать использоваться предприятием в течение многих лет. Однако, необоротные активы *изнашиваются* **(wear out)**, становятся *непригодными* **(unusable)** либо *устаревшими* **(obsolete)** и *со временем* **(eventually)** *теряют стоимость* **(decrease in value)**. *Следовательно* **(Consequently)**, необоротные активы *обесцениваются* **(are depreciated)** – их стоимость *по балансу* **(on the balance sheet)** уменьшается каждый год *с помощью записи на счет прибыли* **(by a charge against profits)** *в* **(on)** отчете о прибылях и убытках. Другими словами, часть стоимости актива *вычитается* **(is deducted)** из прибылей каждый год. Бухгалтерский *метод* **(technique)** списания *делает ненужным* **(makes it unnecessary)** *записывать всю стоимость* **(to charge the whole cost)** необоротного актива на счет прибылей в тот год, когда актив куплен. *Вместо этого* **(Instead)**, его можно *списывать* **(charged)** в течение всех тех лет, когда он используется. Это пример принципа соответствия.

UNIT 11 Glossary

ACCOUNT A section in a ledger devoted to a single aspect of a business (eg. a Bank account, Wages account, Office expenses account).
ACCOUNTING CYCLE It 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.
ACCOUNTING EQUATION The formula used to prepare a balance sheet: assets = liability + equity .
ACCRUAL METHOD OF ACCOUNTING Most businesses use the accrual method of accounting (because it is usually required by law). When you issue an invoice on credit (i.e. regardless of whether it is paid or not), it is treated as a taxable supply on the date it was issued for income tax purposes (or corporation tax for limited companies). The same applies to bills received from suppliers. (This does not mean you

pay income tax immediately, just that it must be included in that year's profit and loss account).

ACCRUAL OR MATCHING CONCEPT this concept recognizes revenues and costs as they are earned or incurred rather than as money is received or paid. The income statement is prepared for a uniform time period and the accountant must ensure that revenues and expenses of activities undertaken in that period are matched within that period.

AMORTIZATION The depreciation (or repayment) of an (usually) intangible asset (e.g. loan, mortgage) over a fixed period of time. Example: if a loan of 12,000 is amortized over 1 year with no interest, the monthly payments would be 1000 a month.

ANNUAL GENERAL MEETING (A.G.M.) It is a meeting that official bodies, and associations involving the public, are often required by law (or the constitution, charter, by-laws etc. governing the body) to hold. An AGM is held every year to elect the Board of Directors and inform their members of previous and future activities. It is an opportunity for the shareholders and partners to receive copies of the company's accounts as well as reviewing fiscal information for the past year and asking any questions regarding the directions the business will take in the future.

APPROPRIATION ACCOUNT An account in the nominal ledger which shows how the net profits of a business (usually a partnership, limited company or corporation) have been used.

ASSETS Assets represent what a business owns or is due. Equipment, vehicles, buildings, creditors, money in the bank, cash are all examples of the assets of a business. Typical breakdown includes 'Fixed assets', 'Current assets' and 'non-current assets'. Fixed refers to equipment, buildings, plant, vehicles etc. Current refers to cash, money in the bank, debtors etc. Non-current refers to any assets which do not easily fit into the previous categories (such as Deferred expenditure).

AT COST The 'at cost' price usually refers to the price originally paid for something, as opposed to, say, the retail price.

AUDIT The process of checking every entry in a set of books to make sure they agree with the original paperwork (e.g. checking a journal's entries against the original purchase and sales invoices).

BALANCE SHEET A summary of all the accounts of a business. Usually prepared at the end of each financial year. The term 'balance sheet' implies that the combined balances of assets exactly equals the liabilities and equity (aka net worth).

BANK OVERDRAFT This occurs when the bank allows the company to withdraw funds in excess of its present balance. They are legally repayable 'on demand' and are therefore included as a current liability, even when such arrangements may last for a longer period.

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.

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

CAPITAL An amount of money put into the business (often by way of a loan) as opposed to money earned by the business.

CASH A current asset account which includes currency, coins, checking accounts, and undeposited checks received from customers. The amounts must be unrestricted. (Restricted cash should be recorded in a different account.)

CASH FLOW STATEMENT A report which shows the flow of money in and out of the business over a period of time.

CASH IN HAND See UNDEPOSITED FUNDS ACCOUNT

CONSISTENCY This means adopting the same procedure every time for recording and measuring items. If this were not followed the comparison of accounts from one period to another would be meaningless.

COOK THE BOOKS Falsify a set of accounts. See also CREATIVE ACCOUNTING

CREATIVE ACCOUNTING A questionable means of making a company's figures appear more (or less) appealing to shareholders etc. An example is 'branding' where the 'value' of a brand name is added to intangible assets which increases shareholders funds (and therefore decreases the gearing). Capitalizing expenses is another method (i.e. moving them to the assets section rather than declaring them in the Profit & Loss account).

CREDIT A column in a journal or ledger to record the 'From' side of a transaction (eg. if you buy some petrol using a check 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, so you issue the customer with a credit note to say that you owe the customer £25.

CREDITORS This covers goods and services received which have yet to be paid for.

CURRENT ASSETS These comprise short-term resources which will be used up or change their form during the next 12 months. When current liabilities are deducted, the resulting total is often referred to as *working capital* or *circulating capital* because they constantly change form from cash to stock to debtors and back to cash again. This is the life-cycle of the business. The constituent parts will be stocks (raw materials, work-in-progress and finished goods), debtors (amounts owed to the company) and cash (both cash in hand and cash at the bank).

CURRENT LIABILITIES Debts which require payment within 12 months of the balance sheet date. They comprise creditors, bank overdraft, taxation and dividends payable.

DEBENTURE This is a type of share issued by a limited company. It is the safest type of share in that it is really a loan to the company and is usually tied to some of the company's assets so should the company fail, the debenture holder will have first call on any assets left after the company has been wound up.

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. An account in the nominal ledger which contains the overall balance of the Sales Ledger.

DEPRECIATION The value of assets usually decreases as time goes by. The amount or percentage it decreases by is called depreciation. This is normally calculated at the end of every accounting period (usually a year) at a typical rate of 25% of its last value. It is shown in both the profit & loss account and balance sheet of a business. See straight-line depreciation .

DIVIDENDS These are payments to the shareholders of a limited company.

DIVIDENDS PAYABLE An amount of profit set aside to cover the proposed final dividend. Once it has received approval at the company's A.G.M. it can be paid to shareholders.

DOUBLE-ENTRY All transactions involve two sides: giving and receiving. This is acknowledged in the double-entry system of book-keeping where the acquisition of funds is balanced by the use made of them.

DOUBLE-ENTRY BOOKKEEPING 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, then expanded upon by L Paccioli in the 15th century.

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

EQUITY 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 and Fixed Assets). These represent the amounts charged against profit in respect of goods and services consumed during an accounting period.

FIFO First In First Out. A method of valuing stock.

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 (eg. 1st April 2001 to 31st March 2002).

FIXED ASSETS Long-term resources of the business which are designated to be used for more than one accounting period. They include such items as property, plant and machinery, office equipment and vehicles, fixtures and fittings.

FIXTURES AND FITTINGS This is a class of fixed asset which includes office furniture, filing cabinets, display cases, warehouse shelving and the like.

FLOW OF FUNDS STATEMENT This is a report which shows how a balance sheet has changed from one period to the next.

GOING CONCERN The organization is assumed to be an enterprise that will 'continue in business for the forseeable future". In practical terms this means valuing assets at cost on the assumption they are worth at least that amount. If a business were planning to close down, the most important information would be *realizable value* (value if sold) of the assets, which might be less or more than cost, e.g. machinery and land.

GOODWILL This is an extra value placed on a business if the owner of a business decides it is worth more than the value of its assets. It is usually included where the business is to be sold as a going concern.

GROSS LOSS The balance of the trading account assuming it has a debit balance.

GROSS PROFIT The balance of the trading account assuming it has a credit balance.

HISTORIC COST All items are valued at cost. Where items fall in value through use they are depreciated or written down in value. Note however that freehold land and buildings are revalued at intervals, with the surplus or deficit on revaluation being reflected in the accounts.

INCOME Money received by a business from its commercial activities. See 'Revenue'.

INSOLVENT A company is insolvent if it has insufficient funds (all of its assets) to pay its debts (all of its liabilities). If a company's liabilities are greater than its assets and it continues to trade, it is not only insolvent, but in the UK, is operating illegally (Insolvency act 1986).

INTANGIBLE ASSETS Assets of a non-physical or financial nature. An asset such as a loan or an endowment policy are good examples. See tangible assets .

INVENTORY A subsidiary ledger which is usually used to record the details of individual items of stock. Inventories can also be used to hold the details of other assets of a business.

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).

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.
LEDGER A book in which entries posted from the journals are re-organised into accounts..
LIABILITIES This includes bank overdrafts, loans taken out for the business and money owed by the business to its suppliers. Liabilities are included on the right hand side of the balance sheet and normally consist of accounts which have a credit balance.
LIFE-CYCLE OF BUSINESS The seven stages of business life: seed stage, start-up stage, growth stage, established stage, expansion stage, decline stage, and exit stage.
LIFO Last In First Out. A method of valuing stock .
LILO Last In Last Out. A method of valuing stock .
LONG-TERM LIABILITIES Borrowings which are not due to be repaid for at least 12 months. These comprise long-term bank loans and debentures, which are borrowings from the public and are listed on the Stock Exchange in the same manner as ordinary shares. Long-term loans may often be secured against the company's assets.

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 the Inland Revenue and any other parties not directly connected with the business.
MATCHING PRINCIPLE A method of analyzing the sales and expenses which make up those sales to a particular period (eg. if a builder sells a house then the builder will tie in all the raw materials and expenses incurred in building and selling the house to one period - usually in order to see how much profit was made).
MONEY MEASUREMENT All company assets and liabilities are measured in a common unit, money. Intangible assets such as goodwill and management skill which are of value to the company are left out of the accounts, as they cannot accurately be measured in money terms.
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 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 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).
OBJECTIVITY As far as possible accounts should be based on facts which are measurable and can be independently verified.
OVERHEADS These are the costs involved in running a business. They consist entirely of expense accounts (e.g. rent, insurance, petrol, staff wages etc.).
POSTING The copying of entries from the journals to the ledgers.
PROFIT The excess of revenue over expenses. If expenses are greater than revenues then a loss (i.e. negative profit) results. There are many definitions of profit which can be best appreciated with reference to the Profit and Loss Statement.
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). Often referred to as a P&L.
PRO-FORMA INVOICE An invoice sent that requires payment before any goods or services have been dispatched.
PRUDENCE AND CONSERVATISM This concept is designed to balance the natural optimism of the businessman! It encourages the accountant to be prudent by recognizing revenue only when it is realized in an acceptable form whilst providing for all expenses and losses as they are known. For example, if a company gives a potential customer a quotation for some building work, the amount quoted could not be treated as a sale. When a sales invoice is eventually raised, the ‘sale’ can be recognized.
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.
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, ie. its 'real' (or realized) value.

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).

RETAINED EARNINGS This is the amount of money held in a business after its owner(s) have taken their share of the profits.

REVENUE The total exchange value of the goods or services of a business which have been transferred to a customer in return for cash or some other asset, e.g. debtors. The sales and any other taxable income of a business (e.g. interest earned from money on deposit).

SALES Income received from selling goods or a service. See Revenue .

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.

SEPARATE ENTITY The company is recognized as a legal 'person' in its own right entirely separate from its owners and managers.

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.

STANDARD ACCOUNTING PRACTICE A set of rules that a company must follow when reporting information on its financial statement. The standard accounting practice guidelines allow companies to be compared to each other because they have followed the same rules. The standard methods in the U.S. are referred to as Generally Accepted Accounting Principles.

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

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.

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 .

TAXATION This comprises the corporation tax levied on the current period's profits which is due for payment in the next year.

TRADING ACCOUNT An account which shows the gross profit or loss of a manufacturing or retail business, i.e. sales less the cost of sales.

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).

UNDEPOSIRED FUND ACCOUNT An account used to show the current total of money received (i.e. not yet banked or spent). The 'funds' can include money, checks, credit card payments, banker's drafts etc. This type of account is also commonly referred to as a 'cash in hand' account.

VALUE-ADDED TAX **(VAT - applies to many countries):** Value Added Tax, or VAT as it is usually called is a sales tax which increases the price of goods. At the time of writing the UK VAT standard rate is 17.5%, there is also a rate for fuel which is 5% (this refers to heating fuels like coal, electricity and gas and not 'road fuels' like petrol which is still rated at 17.5%). VAT is added to the price of goods so in the UK, an item that sells at £10 will be priced £11.75 when 17.5% VAT is added.

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.

WRITE-OFF Depreciating an asset to zero in one go.

WORKING CAPITAL Current assets minus current liabilities.