39 Basic Financial Terms You Should Know

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01.**Assets**

Anything owned by the company having a monetary value; eg, 'fixed' assets like buildings, plant and machinery, vehicles (these are not assets if rentedand not owned) and potentially including intangibles like trade marks and brand names, and 'current' assets, such as stock, debtors and cash.

02. Asset turnover

Measure of operational efficiency - shows how much revenue is produced per £ of assets available to the business. (sales revenue/total assets less current liabilities)

03.Balance sheet

The Balance Sheet is one of the three essential measurement reports for the performance and health of a company along with the Profit and Loss Account and the Cash flow Statement. The Balance Sheet is a 'snapshot' in time of who owns what in the company, and what assets and debts represent the value of the company. (It can only ever be a snapshot because the picture is always changing.) The Balance Sheet is where to look for information about short-term and long-term debts, gearing (the ratio of debt to equity), reserves, stock values (materials and finished goods), capital assets, cash on hand, along with the value of shareholders' funds. The term 'balance sheet' is derived from the simple purpose of detailing where the money came from, and where it is now. The balance sheet equation is fundamentally: (where the money came from) Capital + Liabilities = Assets (where the money is now). Hence the term 'double entry' - for every change on one side of the balance sheet, so there must be a corresponding change on the other side - it must always balance. The Balance Sheet does not show how much profit the company is making (the P&L does this), although pervious years' retained profits will add to the company's reserves, which are shown in the balance sheet.

04.Budget

In a financial planning context the word 'budget' (as a noun) strictly speaking means an amount of money that is planned to spend on a particular activity or resource. This is typically over a trading year, although budgets apply to shorter and longer periods, and may refer to costs allocated to projects of flexible timescales. An overall organizational plan usually contains the budgets within it for all the different departments and costs held by them. The verb 'to budget' means to calculate and set a budget, although in a looser context it also means to be careful with money and find reductions (effectively by setting and maintaining a lower 'budgeted' or reduced level of expenditure). The word budget is also more loosely used by many people to mean the whole organizational business or operating financial plan. In this context a budget means the same as a plan (and a business plan, or an operating plan or trading plan, etc). For example in the UK the Government's annual plan is called 'The Budget'. A 'forecast' in certain contexts means the same as a budget - either a planned individual activity/resource cost, or a whole business/ corporate/organizational plan.

A 'forecast' more commonly (and precisely in my view) means a prediction of performance - costs and/or revenues, or other data such as headcount, % performance, etc., especially when the 'forecast' is made during the trading period, and normally after the plan or 'budget' has been approved. In simple terms: budget = plan or a cost element within a plan; forecast = updated budget or plan. The verb forms are also used, meaning the act of calculating the budget or forecast.

05. Capital employed

The value of all resources available to the company, typically comprising share capital, retained profits and reserves, long-term loans and deferred taxation. Viewed from the other side of the balance sheet, capital employed comprises fixed assets, investments and the net investment in working capital (current assets less current liabilities). In other words: the total long-term funds invested in or lent to the business and used by it in carrying out its operations.

06. Cashflow

The movement of cash in and out of a business from day-to-day direct trading and other non-trading or indirect effects, such as capital expenditure, tax and dividend payments.

07. Cashflow statement

One of the three essential reporting and measurement systems for any company. The cashflow statement provides a third perspective alongside the Profit and Loss account and Balance Sheet. The Cashflow statement shows the movement and availability of cash through and to the business over a given period, certainly for a trading year, and often also monthly and cumulatively. The availability of cash in a company that is necessary to meet payments to suppliers, staff and other creditors is essential for any business to survive, and so the reliable forecasting and reporting of cash movement and availability is crucial.

08. Cost of debt ratio (average cost of debt ratio)

Despite the different variations used for this term (cost of debt, cost of debt ratio, average cost of debt ratio, etc) the term normally and simply refers to the interest expense over a given period as a percentage of the average outstanding debt over the same period, ie., cost of interest divided by average outstanding debt.

09. Cost of goods sold (COGS)

The directly attributable costs of products or services sold, (usually materials, labour, and direct production costs). Sales less COGS = gross profit. Effetively the same as cost of sales (COS) see below for fuller explanation.

10. Cost of sales (COS)

Commonly arrived at via the formula: opening stock + stock purchased - closing stock.

Cost of sales is the value, at cost, of the goods or services sold during the period in question, usually the financial year, as shown in a Profit and Loss Account (P&L). In all accounts, particularly the P&L (trading account) it's important that costs are attributed reliably to the relevant revenues, or the report is distorted and potentially meaningless. To use simply the total value of stock purchases during the period in question would not produce the correct and relevant figure, as some product sold was already held in stock before the period began, and some product bought during the period remains unsold at the end of it. Some stock held before the period often remains unsold at the end of it too. The formula is the most logical way of calculating the value at cost of all goods sold, irrespective of when the stock was purchased. The value of the stock attributable to the sales in the period (cost of sales) is the total of what we started with in stock (opening stock), and what we purchased (stock purchases), minus what stock we have left over at the end of the period (closing stock).

11. Current assets

Cash and anything that is expected to be converted into cash within twelve months of the balance sheet date.

12. Current ratio

The relationship between current assets and current liabilities, indicating the liquidity of a business, ie its ability to meet its short-term obligations. Also referred to as the Liquidity Ratio.

13. Current liabilities

Money owed by the business that is generally due for payment within 12 months of balance sheet date. Examples: creditors, bank overdraft, taxation.

14. Depreciation

The apportionment of cost of a (usually large) capital item over an agreed period, (based on life expectancy or obsolescence), for example, a piece of equipment costing £10k having a life of five years might be depreciated over five years at a cost of £2k per year. (In which case the P&L would show a depreciation cost of £2k per year; the balance sheet would show an asset value of £8k at the end of year one, reducing by £2k per year; and the cashflow statement would show all £10k being used to pay for it in year one.)

15. Dividend

A dividend is a payment made per share, to a company's shareholders by a company, based on the profits of the year, but not necessarily all of the profits, arrived at by the directors and voted at the company's annual general meeting. A company can choose to pay a dividend from reserves following a loss-making year, and conversely a company can choose to pay no dividend after a profit-making year, depending on what is believed to be in the best interests of the company. Keeping shareholders happy and committed to their investment is always an issue in deciding dividend payments. Along with the increase in value of a stock or share, the annual dividend provides the shareholder with a return on the shareholding investment.

16. Fixed assets

Assets held for use by the business rather than for sale or conversion into cash, eg, fixtures and fittings, equipment, buildings.

17. Fixed cost

A cost which does not vary with changing sales or production volumes, eg, building lease costs, permanent staff wages, rates, depreciation of capital items.

18. Goodwill

Any surplus money paid to acquire a company that exceeds its net tangible assets value.

19. gross profit

Sales less cost of goods or services sold. Also referred to as gross profit margin, or gross profit, and often abbreviated to simply 'margin'. See also 'net profit'.

20. Initial Public Offering (IPO)

An Initial Public Offering (IPO being the Stock Exchange and corporate acronym) is the first sale of privately owned equity (stock or shares) in a company via the issue of shares to the public and other investing institutions. In other words an IPO is the first sale of stock by a private company to the public. IPOs typically involve small, young companies raising capital to finance growth. For investors IPOs can risky as it is difficult to predict the value of the stock (shares) when they open for trading. An IPO is effectively 'going public' or 'taking a company public'.

21. Letters of credit (信用狀)

These mechanisms are used by exporters and importers, and usually provided by the importing company's bank to the exporter to safeguard the contractual expectations and particularly financial exposure of the exporter of the goods or services. (Also called 'export letters of credit, and 'import letters of credit'.)

When an exporter agrees to supply a customer in another country, the exporter needs to know that the goods will be paid for.

The common system, which has been in use for many years, is for the customer's bank to issue a 'letter of credit' at the request of the buyer, to the seller. The letter of credit essentially guarantees that the bank will pay the seller's invoice (using the customer's money of course) provided the goods or services are supplied in accordance with the terms stipulated in the letter, which should obviously reflect the agreement between the seller and buyer. This gives the supplier an assurance that their invoice will be paid, beyond any other assurances or contracts made with the customer. Letters of credit are often complex documents that require careful drafting to protect the interests of buyer and seller. The customer's bank charges a fee to issue a letter of credit, and the customer pays this cost.

The seller should also approve the wording of the buyer's letter of credit, and often should seek professional advice and guarantees to this effect from their own financial services provider.

In short, a letter of credit is a guarantee from the issuing bank's to the seller that if compliant documents are presented by the seller to the buyer's bank, then the buyer's bank will pay the seller the amount due. The 'compliance' of the seller's documentation covers not only the goods or services supplied, but also the timescales involved, method for, format of and place at which the documents are presented.

22. letters of guarantee (擔保書)

There are many types of letters of guarantee. These types of letters of guarantee are concerned with providing safeguards to buyers that suppliers will meet their obligations or vice-versa, and are issued by the supplier's or customer's bank depending on which party seeks the guarantee. While a letter of credit essentially guarantees payment to the exporter, a letter of guarantee provides safeguard that other aspects of the supplier's or customer's obligations will be met. The supplier's or customer's bank is effectively giving a direct guarantee on behalf of the supplier or customer that the supplier's or customer's obligations will be met, and in the event of the supplier's or customer's failure to meet obligations to the other party then the bank undertakes the responsibility for those obligations.

23.Liabilities

General term for what the business owes. Liabilities are long-term loans of the type used to finance the business and short-term debts or money owing as a result of trading activities to date . Long term liabilities, along with Share Capital and Reserves make up one side of the balance sheet equation showing where the money came from. The other side of the balance sheet will show Current Liabilities along with various Assets, showing where the money is now.

24. Liquidity ratio

Indicates the company's ability to pay its short term debts, by measuring the relationship between current assets (ie those which can be turned into cash) against the short-term debt value. (current assets/current liabilities) Also referred to as the Current Ratio.

25. Net assets (also called total net assets)

Total assets (fixed and current) less current liabilities and long-term liabilities that have not been capitalised (eg, short-term loans).

26. Net current assets

Current Assets less Current Liabilities.

27. Net Present Value (NPV)

NPV is a significant measurement in business investment decisions. NPV is essentially a measurement of all future cashflow (revenues minus costs, also referred to as net benefits) that will be derived from a particular investment (whether in the form of a project, a new product line, a proposition, or an entire business), minus the cost of the investment. Logically if a proposition has a positive NPV then it is profitable and is worthy of consideration. If negative then it's unprofitable and should not be pursued. While there are many other factors besides a positive NPV which influence investment decisions; NPV provides a consistent method of comparing propositions and investment opportunities from a simple capital/investment/profit perspective. There are different and complex ways to construct NPV formulae, largely due to the interpretation of the 'discount rate' used in the calculations to enable future values to be shown as a present value. Corporations generally develop their own rules for NPV calculations, including discount rate. NPV is not easy to understand for non-financial people - wikipedia seems to provide a good detailed explanation if you need one.

28. Net profit

Net profit can mean different things so it always needs clarifying. Net strictly means 'after all deductions' (as opposed to just certain deductions used to arrive at a gross profit or margin). Net profit normally refers to profit after deduction of all operating expenses, notably after deduction of fixed costs or fixed overheads. This contrasts with the term 'gross profit' which normally refers to the difference between sales and direct cost of product or service sold (also referred to as gross margin or gross profit margin) and certainly before the deduction of operating costs or overheads. Net profit normally refers to the profit figure before deduction of corporation tax, in which case the term is often extended to 'net profit before tax' or PBT.

29. P/E ratio (price per earnings)本益比

The P/E ratio is an important indicator as to how the investing market views the health, performance, prospects and investment risk of a public company listed on a stock exchange (a listed company). The P/E ratio is also a highly complex concept - it's a guide to use alongside other indicators, not an absolute measure to rely on by itself. The P/E ratio is arrived at by dividing the stock or share price by the earnings per share (profit after tax and interest divided by the number of ordinary shares in issue). As earnings per share are a yearly total, the P/E ratio is also an expression of how many years it will take for earnings to cover the stock price investment. P/E ratios are best viewed over time so that they can be seen as a trend. A steadily increasing P/E ratio is seen by the investors as increasingly speculative (high risk) because it takes longer for earnings to cover the stock price. Obviously whenever the stock price changes, so does the P/E ratio. More meaningful P/E analysis is conducted by looking at earnings over a period of several years. P/E ratios should also be compared over time, with other company's P/E ratios in the same market sector, and with the market as a whole. Step by step, to calculate the P/E ratio:

1. Establish total profit after tax and interest for the past year.
2. Divide this by the number of shares issued.
3. This gives you the earnings per share.
4. Divide the price of the stock or share by the earnings per share.
5. This gives the Price/Earnings or P/E ratio.

30. Profit and Loss Account (P&L) 損益表

an account in the books of an organization to which incomes and gains are credited and expenses and losses debited, so as to show the net profit or loss over a given period.

One of the three principal business reporting and measuring tools (along with the balance sheet and cashflow statement). The P&L is essentially a trading account for a period, usually a year, but also can be monthly and cumulative. It shows profit performance, which often has little to do with cash, stocks and assets (which must be viewed from a separate perspective using balance sheet and cashflow statement). The P&L typically shows sales revenues, cost of sales/cost of goods sold, generally a gross profit margin (sometimes called 'contribution'), fixed overheads and or operating expenses, and then a profit before tax figure (PBT). A fully detailed P&L can be highly complex, but only because of all the weird and wonderful policies and conventions that the company employs. Basically the P&L shows how well the company has performed in its trading activities.

31. Quick ratio (速動比率)

Same as the Acid Test. The relationship between current assets readily convertible into cash (usually current assets less stock) and current liabilities. A sterner test of liquidity.

32. Reserves(儲量)

The accumulated and retained difference between profits and losses year on year since the company's formation.

33. Return on capital employed (ROCE) 資本回報率

A fundamental financial performance measure. A percentage figure representing profit before interest against the money that is invested in the business. (profit before interest and tax, divided by capital employed, x 100 to produce percentage figure.)

34. Return on investment 投資報酬率

Another fundamental financial and business performance measure. This term means different things to different people (often depending on perspective and what is actually being judged) so it's important to clarify understanding if interpretation has serious implications. Many business managers and owners use the term in a general sense as a means of assessing the merit of an investment or business decision. 'Return' generally means profit before tax, but clarify this with the person using the term - profit depends on various circumstances, not least the accounting conventions used in the business. In this sense most CEO's and business owners regard ROI as the ultimate measure of any business or any business proposition, after all it's what most business is aimed at producing - maximum return on investment, otherise you might as well put your money in a bank savings account. Strictly speaking Return On Investment is defined as:

Profits derived as a proportion of and directly attributable to cost or 'book value' of an asset, liability or activity, net of depreciation.

In simple terms this **the profit made from an investment**. The 'investment' could be the value of a whole business (in which case the value is generally regarded as the company's total assets minus intangible assets, such as goodwill, trademarks, etc and liabilities, such as debt. N.B. A company's book value might be higher or lower than its market value); or the investment could relate to a part of a business, a new product, a new factory, a new piece of plant, or any activity or asset with a cost attached to it.

The main point is that the term seeks to define the profit made from a business investment or business decision. Bear in mind that costs and profits can be ongoing and accumulating for several years, which needs to be taken into account when arriving at the correct figures.

35.Share Capital (股本)

The balance sheet nominal value paid into the company by shareholders at the time(s) shares were issued.

36. Shareholders' funds(股東資金)

A measure of the shareholders' total interest in the company represented by the total share capital plus reserves.

37. T/T (Telegraphic Transfer) 電滙

Interntional banking payment method: a telegraphic transfer payment, commonly used/required for import/export trade, between a bank and an overseas party enabling transfer of local or foreign currency by telegraph, cable or telex. Also called a cable transfer. The terminology dates from times when such communications were literally 'wired' - before wireless communications technology.

38. Variable Cost

A cost which varies with sales or operational volumes, eg materials, fuel, commission payments.

39. Working Capital(流動資金)

Current assets less current liabilities, representing the required investment, continually circulating, to finance stock, debtors(債務人), and work in progress.

42 Important Financial Terms You Should Know

Written and designed by Dr. Chao Yuang Shiang

You may already be well versed in financial terms, but if you are open to a refresher course or expanding your financial word bank, this post is for you. I've taken 42 financial terms that I feel are important for general personal finance and gave a brief definition of each term. Most are just a sentence or two and give a simple definition of the term.

I hope you benefit from reading through this list (or maybe emailing it to a friend) – I know I got a nice refresher on some of the terms I don't use every day!

Financial Terms Defined

1. **Amortization**
   – Paying off of debt in regular payments over a period of time.
2. **Assets-**Anything owned by the company having a monetary value; eg, 'fixed' assets like buildings, plant and machinery, vehicles (these are not assets if rentedand not owned) and potentially including intangibles like trade marks and brand names, and 'current' assets, such as stock, debtors and cash.
3. **Asset turnover-**Measure of operational efficiency - shows how much revenue is produced per £ of assets available to the business. (sales revenue/total assets less current liabilities)

4. Annuity – A financial product designed to grow an individual's funds and then upon annuitization, pay a fixed payment for the designated number of periods. Annuities are used primarily as a way to secure cash flow during retirement years.

5. APR – Annual Percentage Rate. The annual cost of a loan; including all fees and interest. Expressed as a percentage.

6. APY – Annual Percent Yield. The annual return of an investment for a one-year period. This rate includes compounding, which makes it greater than the periodic interest rate multiplied by the number of periods.

7. Asset – Any resource that has economic value that an individual or corporation owns. Assets are generally viewed as resources that produce cash flow or bring added benefit to the individual or company.

8. Bankruptcy – A legal proceeding in which a debtor's assets are liquidated and the debtor is released from further liability.

9. Bear Market – A market condition where securities are falling and investors have a pessimistic outlook on the market as a whole. A downturn of 20% or more for more than two months within multiple indexes like the Dow Jones Industrial Average or the S&P 500 is considered the start of a bear market.

10. Bond – A debt instrument used by corporations, governments (including Federal, State and City) and many other institutions that are used to generate capital. The investor does not become part owner like a shareholder, but does have a greater claim on the issuer's income than a shareholder.

11. Bull Market – Opposite of bear market. A market condition where securities rise faster than historic averages;usually from an economic recovery, boom or spike in investor confidence (psychological).

12. Capital Gain – A capital gain is realized when an investment's selling price exceeds its purchase price.

13. Cash Flow – One of the main indications of a company's overall financial health. Calculated by subtracting cash payments from cash receipts over a period of time (month, quarter, year).

14. CD – Certificate of Deposit – Interest bearing note offered by banks, savings and loans, and credit unions. CDs are FDIC insured and provide interest on the investor's money that is locked in for a certain term (usually three months to six years).

15. Compound Interest – Interest that is calculated not just on the initial principal but also on the accumulated interest from previous periods. As interest is added back to the principal, the rate of return applies to the entire balance, making the balance grow even faster than simple interest (simple interest is when the interest is applied only the initial principal, not the accumulated interest as well).

16. Coverdell Educational Savings Account – A replacement to the Educational IRA, the Coverdell ESA is a savings vehicle for parents to use for their child's education. Though contributions to the account are taxed, earnings used for educational expenses are not. The funds within the account must be used for qualified educational expenses before the beneficiary's 30th birthday. Taxes and penalties may apply if distributions are not taken properly.

17. Credit Report – A summary of a person's credit history, showing historical information such as bankruptcies, loans, late payments, and recent inquiries. Individuals can obtain one free credit report from each of the three credit bureaus each year.

18. Credit Score – A measure of credit risk that is based on activities such as credit use and late payments. Credit scores can be obtained for a fee from a one of the three credit bureaus. One of the most common credit scores in the U.S. is the FICO score.

19. Debt – An amount owed to a person or corporation for funds borrowed.

20. Delinquency – When a borrower fails to repay a debt obligation by the agreed term.

21. Diversification – Spreading risk by investing in a range of investment tools such as securities, commodities, real estate, CDs, etc.

22. Garnishment – A legal process whereby a debtor's personal property is seized in order to satisfy a debt or court award.

23. Inflation – The gradual increase or rise in the price of goods of a period of time.

24. Interest – The fee paid for using other people's money. For the borrower, it is the cost of using other people's money. For the lender, it is the income from renting the good (the money).

25. Keogh Plan – A pension plan for self-employed individuals or employees of unincorporated businesses. It is also known as self-employed pension.

26. Liability – An obligation to repay debt.

27. Liquidity – The ability of an asset to be converted to cash quickly without sacrificing value or giving a discount on the price.
28. Loan-to-value – The ratio of the fair market value of the asset to the value of the loan used to purchase the asset. This shows the lender that potential losses may be recouped by selling the asset.
29. Mutual fund – An investment that is made up of a pool of funds from multiple investors who want to invest in securities like stocks, bonds, money market accounts, and other assets. Mutual funds are operated by money managers who invest capital and try to create gains for the investors.
30. Net worth – Basic calculation of assets minus liabilities. Used both for corporations and individuals to measure financial health.
31. Option – A contract that gives the buyer the right, but not the obligation, to buy (call) or sell (put) a security at a price that has been set (strike price) during a set period of time or certain date (exercise date).
32. Prime Rate – Determined by the federal funds rate (the overnight rate at which banks lend to one another) the prime rate is the best rate available to a bank's most credit-worthy customer.
33. Principal – The original investment on which interest is generally paid.
34. Recession – An economic condition defined by a decline in GDP for two or more consecutive quarters. During a recession, the stock market usually drops, unemployment increases, and the housing market declines.
35. Risk Averse – An investors desire to avoid risk; a more conservative approach to investing is generally upheld by risk averse investors.
36. RMD – Required Minimum Distribution – The minimum annual amount required for retirement account holders to withdraw, starting a age 70 ½. This amount is calculated based on the account value on December 31 of the prior year divided by the factor on the IRS RMD table. (RMD does not apply for Roth IRAs.)

37. [Roth IRA](#) – Retirement vehicles that allow certain individuals who meet income restrictions to contribute funds that have already been taxed in order to save for retirement. The withdrawals from Roth IRAs will never be taxed (including interest – after five years of the initial investment).

38. Share – One unit of ownership in a corporation, security, or limited partnership.

39. Stock – A proportional share of ownership of a corporation. A company may offer 100 shares of stock and if you own 10, you have 10% ownership of the company.

40. Tax-deferred – Postponing taxes until a later date – common tax-deferred vehicles include IRAs, 401(k), Keogh Plans, 403(b), and pension plans.

41. Traditional IRA –A retirement vehicle that allows you to save pretax funds for retirement. These funds are taxed upon withdrawal and may be subject to penalty if withdrawn before age 59 ½.

42. Yield – The annual rate of return for an investment expressed as a percentage.