Professional English in Use

Finance

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Contents

INTRODUCTION 6

BASIC TERMS

1 Money and income 8
- A Currency
- B Personal finance

2 Business finance 10
- A Capital
- B Revenue
- C Financial statements

ACCOUNTING

3 Accounting and accountancy 12
- A Accounting
- B Auditing
- C Laws, rules and standards

4 Bookkeeping 14
- A Double-entry bookkeeping
- B Day books and ledgers
- C Balancing the books

5 Company law 1 16
- A Partnerships
- B Limited liability
- C Founding companies

6 Company law 2 18
- A Private and public companies
- B AGMs

7 Accounting policies and standards 20
- A Valuation and measurement
- B Historical cost and inflation accounting

8 Accounting assumptions and principles 22
- A Assumptions
- B Principles

9 Depreciation and amortization 24
- A Fixed assets
- B Valuation
- C Depreciation systems

10 Auditing 26
- A Internal auditing
- B External auditing
- C Irregularities

11 The balance sheet 1 28
- A Assets, liabilities and capital
- B Shareholders' equity

12 The balance sheet 2: assets 30
- A Fixed and current assets
- B Valuation
- C Tangible and intangible assets

13 The balance sheet 3: liabilities 32
- A Liabilities
- B Accrued expenses
- C Shareholders' equity on the balance sheet

14 The other financial statements 34
- A The profit and loss account
- B The cash flow statement

15 Financial ratios 1 36
- A Types of financial ratio
- B Liquidity and solvency ratios
- C Earnings and dividends

16 Financial ratios 2 38
- A Profitability
- B Leverage

17 Cost accounting 40
- A Direct and indirect costs
- B Fixed and variable costs
- C Breakeven analysis

18 Pricing 42
- A Manufacturers' pricing strategies
- B Retail pricing strategies

BANKING

19 Personal banking 44
- A Current accounts
- B Banking products and services
- C E-banking

20 Commercial and retail banking 46
- A Commercial and retail banks
- B Credit
- C Loans and risks

21 Financial institutions 48
- A Types of financial institution
- B Deregulation
- C Specialized banks

22 Investment banking 50
- A Raising capital
- B Mergers and acquisitions
- C Consulting and research

23 Central banking 52
- A The functions of central banks
- B The central bank and the commercial banks
- C Central banks and exchange rates

24 Interest rates 54
- A Interest rates and monetary policy
- B Different interest rates

25 Money markets 56
- A The money markets
- B Common money market instruments
- C Repos

26 Islamic banking 58
- A Interest-free banking
- B Types of accounts
- C Leasing and short-term loans

27 Money supply and control 60
- A Measuring money
- B Changing the money supply
- C Monetarism

CORPORATE FINANCE

28 Venture capital 62
- A Raising capital
- B Return on capital

29 Stocks and shares 1 64
- A Stocks, shares and equities
- B Going public
- C Ordinary and preference shares

30 Stocks and shares 2 66
- A Buying and selling shares
- B New share issues
- C Categories of stocks and shares

31 Shareholders 68
- A Investors
- B Dividends and capital gains
- C Speculators

32 Share prices 70
- A Influences on share prices
- B Predicting prices
- C Types of risks

33 Bonds 72
- A Government and corporate bonds
- B Prices and yields
- C Other types of bonds

34 Futures 74
- A Commodity futures
- B Financial futures

35 Derivatives 76
- A Options
- B In-the-money and out-of-the-money
- C Warrants and swaps

36 Asset management 78
- A Allocating and diversifying assets
- B Types of investor
- C Active and passive investment

37 Hedge funds and structured products 80
- A Hedge funds
- B Leverage, short-selling and arbitrage
- C Structured products

38 Describing charts and graphs 82
A Increase and decrease
B Rate of change
C High points, low points, and staying the same

39 Mergers and takeovers 84
A Mergers, takeovers and joint ventures
B Hostile or friendly?
C Integration

40 Leveraged buyouts 86
A Conglomerates
B Raiders

41 Financial planning 88
A Financing new investments
B Discounted cash flows
C Comparing investment returns

42 Financial regulation and supervision 90
A Government regulation
B Internal controls
C Sarbanes-Oxley

ECONOMICS AND TRADE

43 International trade 92
A Trade
B Balance of payments
C Protectionism

44 Exchange rates 94
A Why exchange rates change
B Fixed and floating rates
C Government intervention

45 Financing international trade 96
A Documentary credits
B Bills of exchange
C Export documents

46 Incoterms 98
A Transport and additional costs
B The E and F terms
C The C and D terms

47 Insurance 100
A Insuring against risks
B Life insurance and saving
C Insurance companies

48 The business cycle 102
A Expansion and contraction
B Fiscal policy
C Monetary policy

49 Taxation 104
A Direct taxes
B Indirect taxes
C Non-payment of tax

50 Business plans 106
A Market opportunities
B The company, the product and the market
C The financial analysis

Language reference 108
Market idioms
Numbers
Word stress
British and American vocabulary

Answer key 114
Index 132
Acknowledgements 140

Introduction

Who is this book for?

Professional English in Use Finance is designed to help intermediate and upper-intermediate learners of business English improve their financial vocabulary – and perhaps their knowledge of finance. It is for people studying English before they start work as well as for those already working who need English in their job.

You can use the book on your own for self-study, or with a teacher in the classroom, one-to-one, or in groups.

How is the book organized?

The book has 50 two-page thematic units, in four areas of finance: **accounting, banking, corporate finance,** and **economics and trade.**

The left-hand page of each unit explains new words and expressions, and the right-hand page allows you to check and develop your understanding of them and how they are used, through a series of exercises.

There is **cross-referencing** between units to show connections between the same word or similar words used in different contexts.

There is also a **Language reference** section, giving examples of idioms used to describe changes in the price of financial assets; showing how to say and write numbers and how to stress English words; and listing differences between British and American financial vocabulary.

There is an **answer key** at the back of the book. Most of the exercises have questions with only one correct answer. But some of the exercises, including the **Over to you** activities at the end of each section (see opposite), are designed for writing and/or discussion about yourself and your own organization, or one you would like to work for.

There is also an **index**. This lists all the new words and expressions introduced in the book, and gives the unit numbers in which they appear. The index also tells you how the words and expressions are pronounced.

The left-hand page

This page introduces new vocabulary for each thematic area. The presentation is divided into sections indicated by letters – usually A, B and C – with simple, clear titles.

As well as explanations of vocabulary, there is information about typical word combinations and the grammar associated with particular vocabulary, for example the verbs that are typically used with certain nouns.

There are also notes on language points, including differences between British and American English.

The right-hand page

The exercises on the right-hand page give practice in using the new vocabulary presented on the left-hand page. Sometimes the exercises concentrate on using the words and expressions presented on the left-hand page in context. Other exercises test your understanding of the concepts on the left-hand page. Some units contain diagrams or tables to complete, or crosswords.

'Over to you' sections

An important feature of *Professional English in Use Finance* is the **Over to you** section at the end of each unit. The **Over to you** sections give you the chance to put into practice the words and expressions in the unit in relation to your own professional situation, studies or opinions. For some of them you will need to find information on the internet or in newspapers.

Self-study learners can do this section as a written activity.

In the classroom, the **Over to you** sections can be used as the basis for discussion with the whole class, or in small groups with a spokesperson for each group summarizing the discussion and its outcome for the class. The teacher can then get learners to look again at the exercises relating to points that have caused difficulty. Learners can follow up by using the **Over to you** section as a written activity, for example as homework.

How to use the book for self-study

Find the topic you are looking for by referring to the contents page or the index. Read through the explanations on the left-hand page of the unit. Do the exercises on the right-hand page. Check your answers in the key. If you have made some mistakes, go back and look at the explanations and exercise again. Note down important words and expressions in your notebook.

How to use the book in the classroom

Teachers can choose units that relate to learners' particular needs and interests, for example areas they have covered in course books, or that have come up in other activities. Alternatively, lessons can contain a regular vocabulary slot, where learners look systematically at the vocabulary of particular thematic areas.

Learners can work on the units in pairs, with the teacher going round the class assisting and advising. Teachers should get learners to think about the logical process of the exercises, pointing out why one answer is possible and others are not.

Cambridge International Certificate in Financial English (ICFE)

Professional English in Use Finance is an ideal self-study or classroom companion for students who are preparing for the Cambridge International Certificate in Financial English (ICFE). Cambridge ICFE is set at levels B2 and C1 of the Council of Europe's Common European Framework of Reference for Languages (CEF). The exam is designed to determine whether candidates whose first language is not English have an adequate level of English to function efficiently, in terms of language ability, within the international finance community.

Cambridge ICFE is for finance students and those already employed in or seeking employment in any finance setting. It is also intended to help employers in international finance with the hiring and training of personnel, and to assist finance faculties and course providers with selection, placement and graduation of students.

We hope you enjoy using this book.

1 Money and income

A Currency

The money used in a country – euros, dollars, yen, etc. – is its **currency**. Money in **notes** (**banknotes**) and **coins** is called **cash**. Most money, however, consists of **bank deposits**: money that people and organizations have in bank accounts. Most of this is **on paper** – existing in theory only – and only about ten per cent of it exists in the form of cash in the bank.

BrE: note or banknote; AmE: bill

B Personal finance

All the money a person receives or **earns** as payment is his or her **income**. This can include:

- a **salary**: money paid monthly by an employer, or **wages**: money paid by the day or the hour, usually received weekly
- **overtime**: money received for working extra hours
- **commission**: money paid to salespeople and agents – a certain percentage of the income the employee generates
- a **bonus**: extra money given for meeting a target or for good financial results
- **fees**: money paid to professional people such as lawyers and architects
- **social security**: money paid by the government to unemployed and sick people
- a **pension**: money paid by a company or the government to a retired person.

Salaries and wages are often paid after deductions such as social security charges and pension contributions.

Amounts of money that people have to **spend** regularly are **outgoings**. These often include:

- **living expenses**: money spent on everyday needs such as food, clothes and public transport
- **bills**: requests for the payment of money owed for services such as electricity, gas and telephone connections
- **rent**: the money paid for the use of a house or flat
- a **mortgage**: repayments of money borrowed to buy a house or flat
- **health insurance**: financial protection against medical expenses for sickness or accidental injuries
- **tax**: money paid to finance government spending.

A financial plan, showing how much money a person or organization expects to earn and spend is called a **budget**.

BrE: social security; AmE: welfare
BrE: flat; AmE: apartment

Planned monthly budget for next year (€)			
Income		**Outgoings**	
Salary (after deductions)	3,250	Rent	900
Commission (average)	600	Bills	250
		Living expenses	1,200
		Health insurance	130
		Tax	800
Total	**3,850**	Total	**3,280**

1.1 Complete the sentences with words from the box. Look at A and B opposite to help you.

commission	bonus	currency	earn	mortgage	tax
overtime	pension	rent	salary	social security	

1 After I lost my job, I was living on .... for three months. This was difficult, because the amount was much lower than the .... I had before.

2 I used to work as a salesperson, but I wasn't very successful, so I didn't .... much ....

3 If the company makes 10% more than last year, we'll all get a .... at the end of the year.

4 It'll take me at least 25 years to repay the .... on my house.

5 Many European countries now have the same .... , the euro.

6 My wages aren't very good, so I do a lot of ....

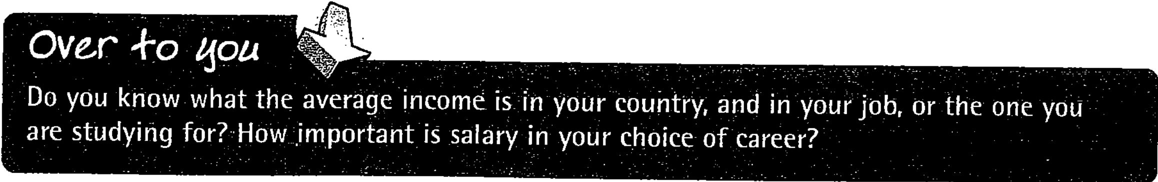
7 Nearly 40% of everything I earn goes to the government as ....

8 The owner has just increased the .... on our flat by 15%.

9 When I retire, my .... will be 60% of my final salary.

1.2 Are the following statements true or false? Find reasons for your answers in A and B opposite.

1 Bank deposits are not classified as money.
2 People earning wages get paid more often than people earning a salary.
3 People working on commission always get paid the same amount.
4 When you stop working at the end of your career, you receive a pension.
5 Most people pay a rent and a mortgage.



2 Business finance

A Capital

When people want to **set up** or start a company, they need money, called **capital**. Companies can **borrow** this money, called a **loan**, from banks. The loan must be paid back with **interest**: the amount paid to borrow the money. Capital can also come from issuing **shares** or **equities** – certificates representing units of ownership of a company. (See Unit 29) The people who **invest** money in shares are called **shareholders** and they **own** part of the company. The money they provide is known as **share capital**. Individuals and financial institutions, called **investors**, can also **lend** money to companies by buying **bonds** – loans that pay interest and are repaid at a fixed future date. (See Unit 33)

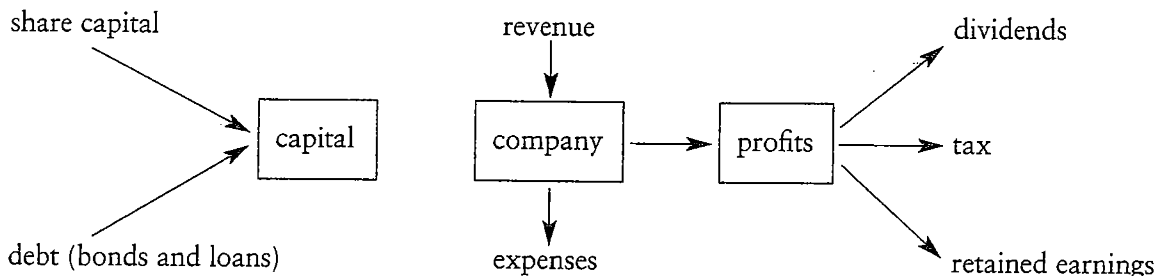
Money that is **owed** – that will have to be paid – to other people or businesses is a **debt**. In accounting, companies' debts are usually called **liabilities**. Long-term liabilities include bonds; short-term liabilities include debts to suppliers who provide goods or services **on credit** – that will be paid for later.

The money that a business uses for everyday expenses or has available for spending is called **working capital** or **funds**.

BrE: shares; AmE: stocks
BrE: shareholder; AmE: stockholder

B Revenue

All the money coming into a company during a given period is **revenue**. Revenue minus the cost of sales and operating **expenses**, such as rent and salaries, is known as **profit**, **earnings** or **net income**. The part of its profit that a company pays to its shareholders is a **dividend**. Companies pay a proportion of their profits to the government as **tax**, to finance government spending. They also **retain**, or keep, some of their earnings for future use.

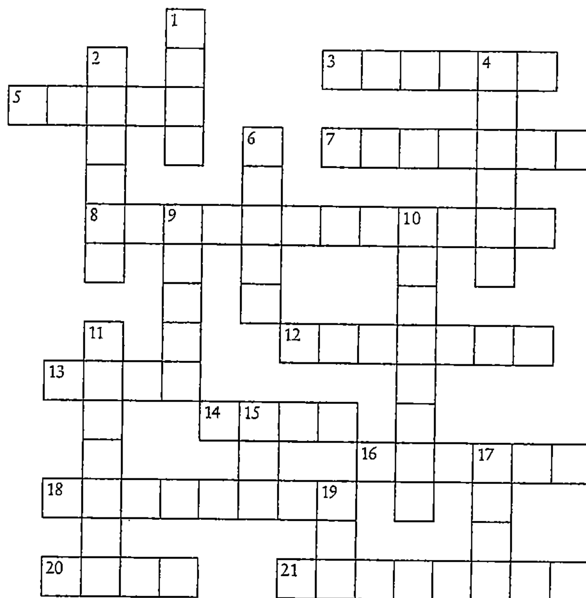


C Financial statements

Companies give information about their financial situation in **financial statements**. The **balance sheet** shows the company's **assets** – the things it owns; its liabilities – the money it owes; and its capital. The **profit and loss account** shows the company's revenues and expenses during a particular period, such as three months or a year.

BrE: profit and loss account; AmE: income statement

2.1 Complete the crossword. Look at A, B and C opposite to help you.



Across

3 Small companies often try to get bank loans when they need to .... money. (6)
5 We don't have sufficient .... to build a completely new factory. (5)
7 and 6 down Details of a company's liabilities are shown on the .... (7,5)
8 We're going to raise more money by selling new shares to our existing .... (12)
12 We had to raise €50,000 .... in order to start the business. (7)
13 We're going to pay back some of the people who lent us money, and reduce our .... (4)
14 I decided to buy a $10,000 .... instead of shares, as it's probably safer. (4)
16 Another term for profit is net .... (6)
18 I think this is a good investment: it pays 8% .... (8)
20 When they saw our financial statements, the bank refused to .... us any more money. (4)
21 Profit is the difference between revenue and .... (8)

Down

1 The profit and .... account shows if a company is receiving more money than it's spending. (4)
2 If you don't like taking risks, you should only .... in very successful companies. (6)
4 A company's retained earnings belong to its .... (6)
6 See 7 across.
9 Anything a company uses to produce goods or services is an .... (5)
10 The company made such a big profit, I expected a higher .... (8)
11 We sold a lot more last year, so our .... went up. (7)
15 We .... our suppliers $100,000 for goods bought on credit. (3)
17 Everyone who buys a share .... part of the company. (4)
19 Thirty per cent of our profits goes straight to the government in .... (3)

"It's been a great year – let's hope we can keep the shareholders from finding out."

Over to you

Think of the company you work for, or one that you are interested in. How was it financed when it was set up, and how is it financed now?

3 Accounting and accountancy

A Accounting

- **Accounting** involves **recording** and summarizing an organization's **transactions** or business deals, such as purchases and sales, and reporting them in the form of financial statements. (See Units 11–14) In many countries, the accounting or **accountancy** profession has professional organizations which operate their own training and examination systems, and make technical and ethical rules: these relate to accepted ways of doing things.
- **Bookkeeping** is the day-to-day recording of transactions.
- **Financial accounting** includes bookkeeping, and **preparing** financial statements for shareholders and **creditors** (people or organizations who have lent money to a company).
- **Management accounting** involves the use of accounting data by managers, for making plans and decisions.

B Auditing

Auditing means examining a company's systems of control and the **accuracy** or exactness of its records, looking for errors or possible **fraud**: where the company may have deliberately given false information.

- An **internal audit** is carried out by a company's own **accountants** or **internal auditors**.
- An **external audit** is done by **independent auditors**: auditors who are not employees of the company.

The external audit examines the truth and fairness of financial statements. It tries to prevent what is called '**creative accounting**', which means recording transactions and values in a way that produces a false result – usually an artificially high profit.

There is always more than one way of presenting accounts. The accounts of British companies have to give a **true and fair view** of their financial situation. This means that the financial statements must give a correct and reasonable picture of the company's current condition.

C Laws, rules and standards

In most continental European countries, and in Japan, there are **laws** relating to accounting, established by the government. In the US, companies whose stocks are traded on public stock exchanges have to **follow rules** set by the Securities and Exchange Commission (SEC), a government agency. In Britain, the rules, which are called **standards**, have been established by independent organizations such as the Accounting Standards Board (ASB), and by the accountancy profession itself. Companies are expected to **apply** or use these standards in their **annual accounts** in order to give a true and fair view.

Companies in most English-speaking countries are largely funded by shareholders, both individuals and financial institutions. In these countries, the financial statements are prepared for shareholders. However, in many continental European countries businesses are largely funded by banks, so accounting and financial statements are prepared for creditors and the tax authorities.

3.1 What type of work does each person do, and what is the name of each job? Look at A and B opposite to help you.

1 I record all the purchases and sales made by this department.

2 This month, I'm examining the accounts of a large manufacturing company.

3 I analyse the sales figures from the different departments and make decisions about our future activities.

4 I am responsible for preparing our annual balance sheet.

5 When the accounts are complete, I check them before they are presented to the external auditors.

3.2 Match the two parts of the sentences. Look at C opposite to help you.

1 In Britain
2 In most of continental Europe and Japan
3 In the USA
4 In Britain and the USA
5 In much of continental Europe

a accounting rules are established by a government agency.
b companies are mainly funded by shareholders or stockholders.
c accounting rules are set by an independent organization.
d the major source of corporate finance is banks.
e accounting rules are set by the government.

3.3 Find verbs in A, B and C opposite that can be used to make word combinations with the nouns below.

.... / .... **an audit**

.... / .... / .... **standards**

.... / .... / .... / .... **rules**

.... / .... **transactions**

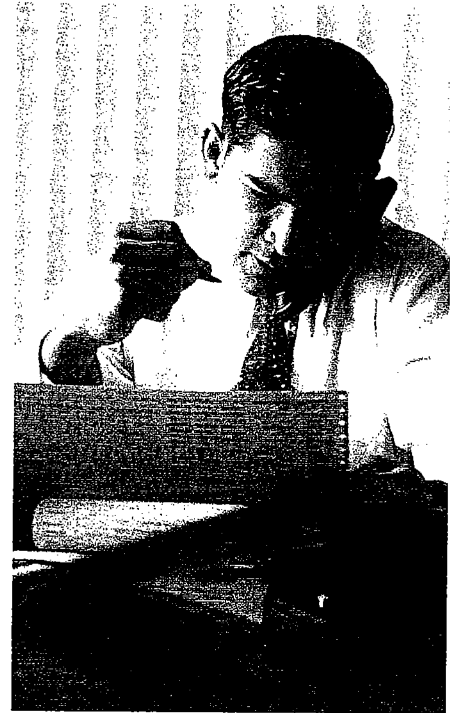
Over to you

Is accounting in your country based on standards, rules, laws, or a mixture of these? What accounting system do international companies in your country use?

4 Bookkeeping

A Double-entry bookkeeping

Zaheer Younis works in the accounting department of a trading company:



'I began my career as a bookkeeper. **Bookkeepers** record the company's daily **transactions**: sales, purchases, debts, expenses, and so on. Each type of transaction is recorded in a separate **account** – the cash account, the liabilities account, and so on. **Double-entry bookkeeping** is a system that records two aspects of every transaction. Every transaction is both a **debit** – a deduction – in one account and a corresponding **credit** – an addition – in another. For example, if a company buys some **raw materials** – the substances and components used to make products – that it will pay for a month later, it debits its purchases account and credits the supplier's account. If the company sells an item on credit, it credits the sales account, and debits the customer's account. As this means the level of the company's **stock** – goods ready for sale – is reduced, it debits the stock account. There is a corresponding increase in its **debtors** – customers who owe money for goods or services purchased – and the debtors or accounts payable account is credited. Each account records debits on the left and credits on the right. If the bookkeepers do their work correctly, the total debits always equal the total credits.'

> BrE: debtors; AmE: accounts receivable
> BrE: creditors; AmE: accounts payable
> BrE: stock; AmE: inventory

B Day books and ledgers

'For accounts with a large number of transactions, like purchases and sales, companies often record the transactions in **day books** or **journals**, and then put a daily or weekly summary in the main double-entry records.

In Britain, they call the main books of account **nominal ledgers**. **Creditors** – suppliers to whom the company owes money for purchases made on credit – are recorded in a **bought ledger**. They still use these names, even though these days all the information is on a computer.'

Note: In Britain the terms **debtors** and **creditors** can refer to people or companies that owe or are owed money, or to the sums of money in an account or balance sheet.

C Balancing the books

'At the end of an **accounting period**, for example a year, bookkeepers prepare a **trial balance** which transfers the debit and credit balances of different accounts onto one page. As always, the total debits should equal the total credits. The accountants can then use these balances to prepare the organization's financial statements.'

4.1 Match the words in the box with the definitions below. Look at A and B opposite to help you.

credit	ledger	debit
creditors	stock	debtors

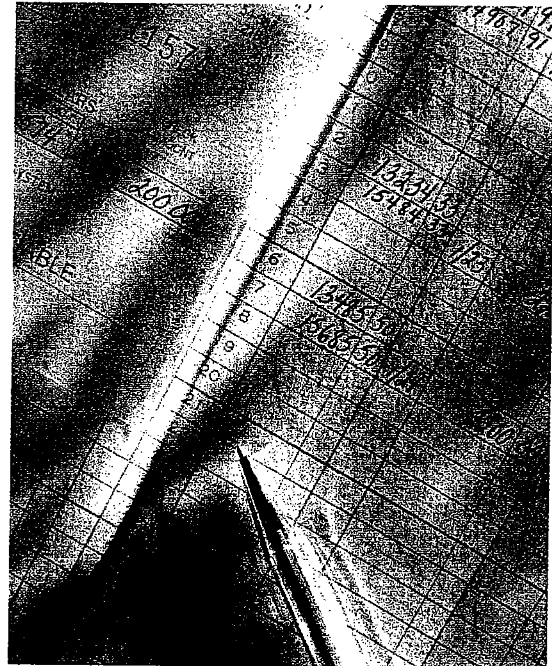
1 an amount entered on the left-hand side of an account, recording money paid out
2 a book of accounts
3 customers who owe money for goods or services not yet paid for
4 an amount entered on the right-hand side of an account, recording a payment received
5 goods stored ready for sale
6 suppliers who are owed money for purchases not yet paid for

4.2 Complete the sentences. Look at A, B and C opposite to help you.

1 .... shows where money comes from and where it goes: it is always transferred from one .... to another one. Every event is entered twice – once as a credit and once as a ....
2 Most businesses record very frequent or numerous transactions in .... or ....
3 The main account books are called ...., and the book relating to creditors is called the ....
4 In order to prepare financial statements, companies do a .... which copies all the debit and credit balances of different accounts onto a single page.

4.3 Complete the sentences using 'debit' or 'credit'. Look at A opposite to help you.

1 If you buy new assets, you .... the cash or capital account.
2 If you pay some bills, you .... the liabilities account.
3 If you buy materials from a supplier on 60 days' credit, you .... the purchases account and .... the supplier's account.
4 If you sell something to a customer who will pay 30 days later, you .... the sales account and .... the customer's account.



Over to you

What qualities does a good bookkeeper need? Would you like to work as a bookkeeper? If not, which type of accounting do you think is the most interesting, and why?

5 Company law 1

A Partnerships

A **partnership** is a business arrangement in which several people work together, and share the risks and profits. In Britain and the US, partnerships do *not* have limited liability for debts, so the **partners** are fully liable or responsible for any debts the business has. Furthermore, partnerships are not legal entities, so in case of a legal action, it is the individual partners and not the partnership that is taken to court. In most continental European countries there are various kinds of partnership which *are* legal entities.

A **sole trader** business – an enterprise owned and operated by a single person – also has unlimited liability for debts.

B Limited liability

A **company** is a business that is a **legal entity**. In other words, it has a separate legal existence from its owners, the shareholders. It can enter into contracts, and can be sued or taken to court if it breaks a contract. A company can (in theory) continue for ever, even if all the staff and owners change. Most companies have **limited liability**, which means that the owners are not fully **liable for** – or responsible for – the business's debts. These companies are known as **limited companies**. Their liability is limited to the value of their **share capital**: the amount of cash that the shareholders have contributed to the company. This limitation of liability encourages investors to risk their money to become part owners of companies, while leaving the management of these companies to qualified managers and senior managers, known as **directors**.

These managers and full-time **executive directors** run the company for its owners. There are standard procedures of **corporate governance** – the way a company is run by the management for the shareholders, and how the managers are accountable to the shareholders. These include separating the job of **chairman** from that of **managing director**, and having several **non-executive directors** on the **board of directors** who do not work full-time for the company but can offer it expert advice. Non-executive directors are often more **objective**: less influenced by their opinions and beliefs. There is also an **audit committee**, containing several non-executive directors, to which the auditors report.

BrE: chairman; AmE: president
BrE: managing director; AmE: chief executive officer (CEO)

C Founding companies

When people **found** or start companies, they **draw up** or prepare **Articles of Association** and a **Memorandum of Association**. The Articles of Association state:

- the rights and duties of the shareholders and directors
- the relationships among different classes of shareholder (See Unit 29)
- the relationships between shareholders and the company and its directors.

The Memorandum of Association states:

- the company's name
- the location of the company's **registered office** – where to send official documents
- the company's **purpose** – its aims or objectives
- the **authorized share capital** – the maximum share capital it can have.

BrE: Articles of Association; AmE: Bylaws
BrE: Memorandum of Association; AmE: Certificate of Incorporation

5.1 Are the following statements true or false? Find reasons for your answers in A and B opposite.

1 In case of a legal dispute, people can take a company's shareholders to court.
2 The owners of limited companies have to pay all the company's debts.
3 Many companies are not owned by their managers.
4 External directors can usually give more objective advice than full-time directors.
5 Partners in British and American businesses are not liable for the partnership's debts.
6 In case of a dispute, people can take British companies and partnerships to court.

5.2 Make word combinations using a word from each box. Then match the word combinations to the definitions below. Look at A opposite to help you.

corporate audit limited non-executive share	committee directors governance capital liability

1 ....: a group of directors to whom the external auditors present their report
2 ....: members of a board of directors who are not full-time managers of the company
3 ....: owners' money invested in a company
4 ....: responsibility for debts up to the value of the company's share capital
5 ....: the way a company is managed for its owners

5.3 Complete the document. Look at C opposite to help you.

(a) ________________ of Association

1. The name of the Company is Language Services Pty Limited.
2. The (b) ________________ of the Company will be in Australia.
3. The (c) ________________ for which the Company is established is to provide translation and interpreting services to international companies.
4. The (d) ____________________ of the company is made up of ordinary shares divided into five thousand (5,000) shares of A$1.00 par value each with one vote for each share.

Over to you

Do partnerships have limited liability in your country? If not, who would you trust enough to start a partnership with?

6 Company law 2

A Private and public companies

Private companies usually have 'Limited' or 'Ltd' at the end of their name. They are not allowed to sell their stocks or shares on an open market. Most companies are private; there are about one million private companies in Britain, compared to around 2,000 **public limited companies** (PLCs). These companies have 'plc' at the end of their name, and their shares are publicly traded on the London Stock Exchange. A **stock exchange** is a market where anyone can buy stocks and shares. The US equivalent of a PLC is a company or **corporation** registered with the Securities and Exchange Commission (SEC).

SEC-registered companies, also known as **listed companies**, have to make **quarterly reports** (i.e. every three months). They report on:

- sales revenue or **turnover** – the money received by the company in that period from selling goods or services
- **gross profit** – turnover less cost of sales
- **net profit** – gross profit less administrative expenses and tax.

Companies on the London Stock Exchange, known as **quoted companies**, have to produce a half-yearly **interim report** which informs shareholders about the company's progress. These reports are not audited.

All companies with shareholders or stockholders have to send them an **Annual Report** each financial year. This contains a review of the year's activity, and an examination and explanation of the company's financial position and results. There are also financial statements and notes (see Units 11–14), and the **auditors' report** on the financial statements.

BARCLAYS PLC Interim Report 2004

Group performance was very strong:
- profit before tax up 23% to £2,411m
- earnings per share up 25% at 26.7p
- dividend per share up 17% to 8.25p
- return on equity of 20.4%

All businesses had higher profits, demonstrating good progress across the whole portfolio.

Income growth was particularly strong, up 14%, with good broad based contributions by business and by income type.

B AGMs

Public companies have to hold an **Annual General Meeting** (AGM), and most private ones do too. At this meeting the shareholders can question directors about the content of the Annual Report and the financial statements, vote to accept or reject the dividend recommended by the directors, and vote on replacements for retiring members of the board. The meeting can also carry out any other business stated in the company's Memorandum of Association or Certificate of Incorporation, and Articles of Association or Bylaws.

If there is a crisis, the directors or the shareholders can request to hold an **Extraordinary General Meeting (EGM)** to discuss the situation. For example, if there are claims of **misconduct** by the directors, where they have behaved illegally, there could be an EGM.

BrE: Annual General Meeting (AGM); AmE: Annual Meeting of Stockholders
BrE: Extraordinary General Meeting (EGM); AmE: Special Meeting

6.1 Complete the table. Look at A and B opposite to help you.

(1) .... companies	Public companies	
■ can't sell shares on the (2)	in the UK	in the US
	■ are called public (3) .... companies or (4) .... companies.	■ are called SEC-registered companies or (6) .... companies.
	■ produce (5) .... reports.	■ produce (7) .... reports.
	■ publish an (8) .... and hold an (9)	

6.2 Find words in A and B opposite with the following meanings.

1 behaviour that breaks the law
2 sales revenue minus the cost of sales, before deductions for administration expenses, interest charges, etc.
3 sales revenue minus the cost of making and selling the goods, and deductions for administration expenses, interest charges, etc.
4 the total amount of money a company receives from selling goods or services

6.3 Match the two parts of the sentences. Look at A and B opposite to help you.

1 Only quoted or listed companies
2 American corporations publish details
3 Companies' financial statements, and the auditor's report,
4 Quarterly and six-monthly reports
5 Shareholders can ask company directors questions
6 Companies can hold an emergency general meeting

a about their sales and profits every three months.
b are contained in their annual reports.
c are not checked by external auditors.
d if there is a crisis.
e can have their shares traded on a stock exchange.
f at an annual meeting.

Over to you

Have you ever been to an AGM? Was there any disagreement between the shareholders and the directors? Who do you think is usually more powerful – the shareholders or the directors?

7 Accounting policies and standards

A Valuation and measurement

Investors in companies want to know how much the companies are worth, so companies regularly have to publish the value of their assets and liabilities. Companies also have to calculate their profits or losses: their managers need this information, and so do shareholders, **bondholders** and the tax authorities.

Companies can choose their **accounting policies** – their way of doing their accounts. There are a range of methods of **valuation** – deciding how much something is worth – and **measurement** – determining how big something is – that are accepted by law or by official accounting standards. In the USA, there are Generally Accepted Accounting Principles (GAAP). In most of the rest of the world there are International Financial Reporting Standards (IFRS), set by the International Accounting Standards Board. These are technical rules or **conventions** – accepted ways of doing things that are not written down in a law.

Although businesses can choose among different accounting policies, they have to be consistent, which means using the same methods every year, unless there is a good reason to change a policy: this is known as the **consistency** principle. The policies also have to be **disclosed** or revealed to the shareholders: the Annual Report will contain a 'Statement of Accounting Policies' that mentions any changes that have been made. This enables shareholders to compare profits and values with those of previous years.

Areas in which the choice of policies can make a big difference to the final profit figure include **depreciation** – reducing the value of assets in the company's accounts (see Unit 9), the valuation of stock or inventory, and the making of **provisions** – amounts of money deducted from profits – for future pension payments.

As there is always more than one way of presenting accounts, the accounts of British companies have to give **a true and fair view** of their financial situation – meaning there are various possibilities – rather than *the* true and fair view – meaning only one is possible.

BrE: depreciation; AmE: depreciation, amortization
BrE: a true and fair view; AmE: a fair presentation

B Historical cost and inflation accounting

The aim of accounting standards (see Unit 3) is to provide shareholders with the information that will allow them to make financial decisions. This is one reason why in many countries accounting follows the **historical cost** principle: companies record the original purchase price of assets, and not their (estimated) current selling price or replacement cost. This is more objective, and the current value is not important if the business is a **going concern** – a successful company that will continue to do business – as its assets are not going to be sold, or do not currently need to be replaced.

However, some countries with regular high inflation, e.g. in South America, use **inflation accounting** systems that take account of changing prices. One system used is **replacement cost accounting,** which values all assets at their **current replacement cost** – the amount that would have to be paid to replace them now.

7.1 Match the two parts of the sentences. Look at A and B opposite to help you.

1 Companies' managers, investors, creditors and the tax authorities all
2 There are different ways of doing accounting but companies have to be consistent,
3 Companies have to disclose or make known
4 The historical cost principle is that the price paid to buy assets,
5 A going concern usually doesn't

a and not their current value, is recorded in accounts.
b need to know the current market value of its assets.
c need to know about the size of profits or losses.
d which accounting methods they are using.
e which means regularly using the same methods.

7.2 Are the following statements true or false? Find reasons for your answers in A and B opposite.

1 Companies are told which accounting policies to use.
2 Companies can change their accounting policies whenever they like, as long as they disclose this in their Annual Report.
3 Companies could produce several profit figures, depending on how they depreciated their assets, valued their inventory, etc.
4 There is only one correct interpretation of a company's financial position, and company accounts must show this.
5 In a lot of countries, companies do not record the current value of their assets.
6 In countries with high inflation, companies value their assets at their current replacement cost.

7.3 Complete the table with words from A and B opposite and related forms. Put a stress mark in front of the stressed syllable in each word. The first one has been done for you.

Verb	Noun(s)	Adjective
	calcu'lation	–
–		consistent
–		conventional
measure		–
present		–
		valuable

Over to you

Which are the most important accounting standards or rules in your country – GAAP, IFRS, IAS, or something else?

8 Accounting assumptions and principles

A Assumptions

When writing accounts and financial statements, accountants have to follow a number of assumptions, principles and conventions. An **assumption** is something that is generally accepted as being true. The following are the main assumptions used by accountants:

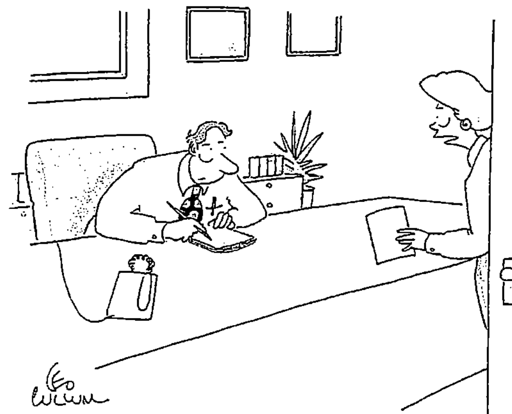
- The **separate entity** or **business entity** assumption is that a business is an accounting unit separate from its owners, creditors and managers, and their assets. These people can all change, but the business continues as before.
- The **time-period** assumption states that the economic life of the business can be divided into (artificial) time periods such as the **financial year**, or a quarter of it.
- The **continuity** or **going concern** assumption says that a business will continue into the future, so the current market value of its assets is not important. (See Unit 7)
- The **unit-of-measure** assumption is that all financial transactions are in a single monetary unit or currency. Companies with **subsidiaries** – that is, other companies that they own – in different countries have to convert their results into one currency in **consolidated financial statements** for the whole group of companies.

> BrE: financial year;
> AmE: fiscal year

B Principles

The following are the most important accounting principles (as well as the **consistency** principle and the **historical cost** principle, mentioned in Unit 7):

- The **full-disclosure** principle states that financial reporting must include *all* significant information: anything that makes a difference to the users of financial statements.
- The principle of **materiality**, however, says that very small and unimportant amounts do not need to be shown.
- The principle of **conservatism** is that where different accounting methods are possible, you choose the one that is least likely to overstate or over-estimate assets or income.
- The **objectivity** principle says that accounts should be based on facts and not on personal opinions or feelings. Accounts, therefore, should be **verifiable**: it should be possible for internal and external auditors to show that they are true. This isn't always possible, however: depreciation or amortization, and provisions for bad debts, for example, are necessarily **subjective** – based on opinions.
- The **revenue recognition** principle is that revenue is recognized in the accounting period in which it is earned. This means the revenue is recorded when a service is provided or goods delivered, not when they are paid for.
- The **matching** principle, which is related to revenue recognition, states that each cost or expense related to revenue earned must be recorded in the same accounting period as the revenue it helped to earn.



"New from accounting, sir. Two and two is four again"

8.1 Match the accounting assumptions and principles (1–6) to the activities they prevent (a–f). Look at A and B opposite to help you.

1 conservatism principle
2 matching principle
3 separate entity assumption
4 revenue recognition principle
5 time-period assumption
6 unit-of-measure assumption

a showing a profit divided into US dollars, euros, Swiss francs, etc.
b publishing financial statements for a 15-month period, because this will show better profits
c waiting until customers pay before recording revenue
d waiting until customers pay before recording expenses
e listing the owners' personal assets in a company's financial statements
f valuing assets and estimating future revenue at the highest possible figures

8.2 Complete the sentences. Look at A and B opposite to help you.

1 A company's .... does not have to begin on 1 January, like the calendar year.
2 If an American company owns a company in Britain, this is a ....
3 Multinationals, with companies in lots of different countries, combine all their results in one set of ....
4 Every entry in a company's accounts must be ....: there must be a document available showing that it is true.

8.3 Complete the table with words from A, B and C opposite and related forms. Put a stress mark in front of the stressed syllable in each word. The first one has been done for you. Then complete the sentences below with words from the table.

Verb	Noun	Adjective
as'sume		–
	disclosure	–
–	objectivity	
recognize		–
–	subjectivity	
	verification	

1 Both the internal and the external auditors have to .... the accounts.
2 Companies have to .... all relevant financial information in their annual reports.
3 Despite the .... principle, accountants have to make some subjective judgements.
4 Even if a company is going through a bad period, for accounting purposes we .... it's a going concern.

Over to you

Look at the Annual Reports of one or two companies. How many of the assumptions and principles described here are mentioned in the notes to the financial statements?

9 Depreciation and amortization

A Fixed assets

A company's assets are usually divided into **current assets** like cash and stock or inventory, which will be used or converted into cash in less than a year, and **fixed assets** such as buildings and equipment, which will continue to be used by the business for many years. But fixed assets **wear out** – become unusable, or become **obsolete** – out of date, and eventually have little or no value. Consequently fixed assets are **depreciated**: their value on a balance sheet is reduced each year by a **charge against profits** on the profit and loss account. In other words, part of the cost of the asset is deducted from the profits each year.

The accounting technique of **depreciation** makes it unnecessary to charge the whole cost of a fixed asset against profits in the year it is purchased. Instead it can be charged during all the years it is used. This is an example of the matching principle. (See Unit 8)

BrE: fixed assets; AmE: property, plant and equipment

B Valuation

Assets such as buildings, machinery and vehicles are grouped together under fixed assets. Land is usually not depreciated because it tends to **appreciate**, or gain in value. British companies occasionally **revalue** – calculate a new value for – appreciating fixed assets like land and buildings in their balance sheets. The revaluation is at either **current replacement cost** – how much it would cost to buy new ones, or at **net realizable value** (**NRV**) – how much they could be sold for. This is not allowed in the USA. Apart from this exception, **appreciation** is only recorded in countries that use inflation accounting systems. (See Unit 7)

Companies in countries which use historical cost accounting – recording only the original purchase price of assets – do not usually record an estimated **market value** – the price at which something could be sold today. The conservatism and objectivity principles support this; and where the company is a going concern, the market value of fixed assets is not important. (See Units 7 and 8)

C Depreciation systems

The most common system of depreciation for fixed assets is the **straight-line method**, which means charging equal annual amounts against profit during the lifetime of the asset (e.g. deducting 10% of the cost of an asset's value from profits every year for 10 years). Many continental European countries allow **accelerated depreciation**: businesses can deduct the whole cost of an asset in a short time. Accelerated depreciation allowances are an **incentive** to investment: a way to encourage it. For example, if a company deducts the entire cost of an asset in a single year, it reduces its profits, and therefore the amount of tax it has to pay. Consequently new assets, including huge buildings, can be valued at zero on balance sheets. In Britain, this would not be considered a true and fair view of the company's assets.

"Let's see, it says here that you've had a lot of corporate accounting experience ..."

9.1 Match the words in the box with the definitions below. Look at A and B opposite to help you.

appreciate	current assets	fixed assets
obsolete	revalue	wear out

1 to record something at a different price
2 assets that will no longer be in the company in 12 months' time
3 to increase rather than decrease in value
4 out of date, needing to be replaced by something newer
5 assets that will remain in the company for several years
6 to become used and damaged

9.2 Match the nouns in the box with the verbs below to make word combinations. Then use some of the word combinations to complete the sentences below. Look at A, B and C opposite to help you.

costs	fixed assets	market value
profits	value	purchase price

deduct ....

record ....

depreciate ....

reduce ....

1 Because we .... the ...., we don't have worry about the market value of fixed assets.
2 To depreciate ...., we .... part of their .... from profits each year.
3 Because land usually appreciates, companies do not generally .... its .... on the balance sheet.

9.3 Match the two parts of the sentences. Look at B and C opposite to help you.

1 All fixed assets can appreciate if there is high inflation,
2 Accelerated depreciation allows companies to
3 Fixed assets generally lose value, except for land,
4 The straight-line method of depreciation
5 Accelerated depreciation reduces companies' tax bills,

a which usually appreciates.
b charges equal amounts against profits every year.
c remove some extremely valuable assets from their balance sheets.
d which encourages them to invest in new factories, etc.
e but historical cost accounting ignores this.

Over to you

Are companies in your country allowed to record huge assets, such as their headquarters, as having zero value on their balance sheets? Is this a good idea?