Glossary of key terms

accounting rate of return (ARR) Annual profit divided by investment. It is a form of return on capital employed. Unlike NPV and IRR, it is based on profits, not cash flows.

capital rationing This is a restriction on an organisation's ability to invest capital funds, caused by an internal budget ceiling being imposed on such expenditure by management (soft capital rationing), or by external limitations being applied to the organisation, for example when additional borrowed funds cannot be obtained (hard capital rationing).

discounted payback The number of years required to repay an original investment using a specified discount rate.

internal rate of return (IRR) The annual percentage return achieved by a project, at which the sum of the discounted cash inflows over the life of the project is equal to the sum of the discounted cash outflows.

investment Any application of funds which is intended to provide a return by way of interest, dividend or capital appreciation.

net present value (NPV) The difference between the sums of the projected discounted cash inflows and outflows attributable to a capital investment or other long-term project.

payback The number of years it takes the cash inflows from a capital investment project to equal the cash outflows. An organisation may have a target payback period, above which projects are rejected.

present value The cash equivalent now of a sum receivable or payable at a future date.

sensitivity analysis A modelling and risk assessment technique in which changes are made to significant variables in order to determine the effect of these changes on the planned outcome. Particular attention is thereafter paid to variables identified as being of special significance.