Rectifying Entries:

Entries necessary to correct the errors in books of accounts are called rectifying entries.

Accounting Cycle:

Accounting cycle includes the following stages:

Transaction ➔ Journal ➔ Ledger ➔ Trial Balance ➔ Financial Statements

Trading Account:

The account which shows the gross result i.e. gross profit or gross loss of the business is known as trading account.

Profit & Loss Account:

The account which shows the net result i.e. net profit or net loss of the business is known as profit & loss account.

Financial Statements

Financial statements are the statements which show the financial performance as well as financial position of the business. Financial statements include income statement, balance sheet, statement of changes in equity, cash flow statement and notes to the accounts.

- **Income Statement:** The statement which shows the financial performance of the business during a particular period is called income statement.
- **Balance Sheet:** Balance sheet is the statement which shows the financial position of the business on a specific date.
- **Cash Flow Statement:** The statement which shows total cash inflows and cash outflows of operating, investing and financing activities.

Real & Fictitious Assets:

- **Real Assets:** Assets which have some market value are called real assets e.g. machinery.
- **Fictitious Assets:** Assets which have no market value are called fictitious assets e.g. preliminary expenses.

Wasting Assets:

Assets whose value gradually reduce on account of use and finally exhausted completely are called wasting assets e.g. mines, forest.

Contingent Liabilities:

Contingent liability is not a liability at present but may or may not become liability in future. It depends upon certain future events.

Difference between Product and Period Cost

- **Product Cost:** Product cost is a cost that is incurred in producing goods & services and included in the value of inventory (direct material, direct labour, manufacturing overheads).
- **Period Cost:** A cost that relates to a time period and are not affected by changes in the level of activity are called period costs e.g. selling and admin expenses.

Difference between Fixed & Variable Cost:

- **Fixed Cost:** Fixed costs are the cost that does not vary with the change in production, if production increases or decrease fixed cost remains constant.
- **Variable Cost:** Variable costs are the costs that vary with the change in production e.g. if production increases variable cost increases, if production decreases variable cost decrease.
- **Step Cost:**

Sunk Cost, Opportunity Cost & Avoidable Cost:

- **Sunk Costs:** Sunk cost is unrecoverable past outlay that is irrelevant to future decision making.
- **Opportunity Cost:** Opportunity cost is the value of the benefit sacrificed when one course of action is chosen, in preference to another. It is also called imputed cost in economics.
- **Avoidable cost:** A cost that can be avoided (in whole or in part) by taking a particular decision is known as avoidable cost.

Costing Methods:

The methods used for the calculation of cost per unit of output are known as costing methods.

- **Job Costing (Job Order Costing):** Job costing applies where work is undertaken according to specific order and individual customer requirements that can be completed in a single accounting period e.g. shipbuilding.
- **Process Costing:** Process costing is used by the companies that are producing large quantities of identical products through continuous operations.
  Unit cost = total manufacturing cost ÷ total units produced

Costing Techniques:

- **Absorption (Full) Costing:** Absorption costing includes variable manufacturing costs e.g. direct material, direct labour and variable manufacturing overheads along with fixed manufacturing overhead costs to each unit of product.
- **Marginal (Variable) Costing:** A costing technique that includes only variable manufacturing costs (direct material, direct labor and variable manufacturing overheads) in unit product costs.
- **Standard Costing:** A costing that uses standards for costs and revenues for the purpose of control through variance analysis.

Corporate Social Responsibility:

A concept that implies that the firm should consider issues such as protecting the consumer, paying fair wages, and considering environmental issues is known as corporate social responsibility.

Corporate Governance:

Corporate governance is the system by which corporations are managed and controlled by senior management. Three key groups in corporate governance are board of directors, executive officer and common shareholders.

Financial Markets:

A market in which people trade financial securities such as stock and bonds is known as financial markets.

- **Primary Market:** A market where new securities are bought and sold for the first time.
- **Secondary Market:** A market where existing securities are bought and sold.
- **Money Market:** A market where short-term government and corporate debt securities are traded.
- **Capital Market:** A market for relatively long-term financial instruments e.g. KSE

Financial Intermediary:

An institution that holds funds borrowed from lenders in order to make investment and to make loans to borrowers e.g. commercial banks.

Time Value of Money:

Time value of money concept says that rupee in hand today is worth more than the rupee you are going to get tomorrow.

Simple and Compound Interest:

- **Simple Interest:** Interest paid on only the original principal borrowed is often referred to as simple interest.
- **Compound Interest:** Interest paid on both the original principal borrowed as well as on unpaid interest is often referred to as compound interest.

Discount Rate:

Interest rate used to convert future values to present value is called discount rate and the process is called discounting.

Compounding and Discounting:

Compounding is a way to determine current value of an investment to its future value while discounting is a way to determine future value of an investment to its current value.

Difference between Sunk Cost and Opportunity Cost:

- **Sunk Costs:** Sunk costs are unrecoverable past outlays that are irrelevant to future decision making.
- **Opportunity Cost:** The value of the benefit sacrificed when one course of action is chosen, in preference to another.

Hurdle Rate:

The minimum required rate of return on an investment in a discounted cash flow analysis. Hurdle rate is the rate at which a project is acceptable.

Capital Rationing:

Capital rationing selects the combination of investment proposals that will provide the greatest increase in the value of the firm within the budget ceiling constraint.

Fisher's Rate of Intersection:

The discount rate at which two projects have identical net present value is referred to as Fisher's rate of intersection.

Types of Project:

Following are the three types of project;

- **Independent Project:** A project whose acceptance does not prevent or require the acceptance of one or more alternative projects.
- **Dependent Project:** A project whose acceptance requires the acceptance of one or more alternative projects.
- **Mutually Exclusive Project:** A project whose acceptance prevent the acceptance of one or more alternative projects.

Post-Completion Audit:

A formal comparison of the actual costs and benefits of a project with original estimates is known as post-completion audit.

Cost of Equity, Debt and Overall Capital:

- **Cost of Equity Capital:** It is the required rate of return on investment of the common shareholders of the company.
- **Cost of debt:** It is the required rate of return on investment of the lenders of the company. Cost of debt is represented by K_d.
- **Overall Cost of Capital:** It is the weighted average of cost of common equity, cost of preferred stock, and cost of debt.

Dividend Reinvestment Plan (DRIP):

An optional plan allowing shareholders to automatically reinvest dividend payments in additional shares of the company's stock is called dividend reinvestment plan.

Public Issue:

Sale of bonds or stock to the general public is called public issue.

Initial Public Offering (IPO):

A company's first offering of common stock directly to general public is called IPO.

Lease:

Lease is a contract giving the right to lessee (user) to use the asset for specific time period, in return for payment to lessor (owner).

- **Operating Lease:** Operating lease refers to a short-term lease that is often cancelable.
- **Financial Lease:** Financial lease is a long-term lease that is not cancelable and its life often matches the useful life of the asset

Underwriting:

Underwriting occurs when the investment banker bears the risk of not being able to sell a new security at the established price.

Fair Market Value:

The price at which an asset can be sold at arm's length transaction is called fair market value.

Difference between Convertibles, Exchangeable and Warrants:

- **Convertible Bond:** Convertible bond is a bond that may be exchanged for common stock of the same company.
- **Exchangeable Bond:** Exchangeable bond allows the holder to exchange the bond for common stock of another company.
- **Warrants:** A warrant is a relatively long-term option to purchase common stock at a specified exercise price over a specified period of time.

Derivative:

A financial asset which derives its value from some underlying asset is called derivative.

- **Put Option:** A contract that gives the holder the right to sell a specified quantity of the underlying assets at a predetermined price on or before a fixed expiration date.
- **Call Option:** A contract that gives the holder the right to purchase a specified quantity of the underlying assets at a predetermined price on or before a fixed expiration date.

Supply:

Supply is that part of stock which a supplier is willing to offer for sale at a given price.

- **Law of Supply:** Law of supply states that increase in price increase in quantity supplied and decreases in price decrease in quantity supplied.

Market:

Market is a place where goods are bought and sold between buyers and sellers.

- **Free Market:** Free market is a market in which the price is determined by the market forces i.e. demand and supply.

Market Equilibrium:

Market equilibrium is a point where market forces such as demand and supply are balanced.

Market Price or Equilibrium Price:

The price which is determined by the market forces such as demand and supply is called market price.

Equilibrium price = price at which quantity demand is equal to quantity supplied.

Factors of Production:

Land, labour, capital and organization are four factors of production (inputs).

Forms of Market:

- **Monopoly:** Monopoly is a form of market in which there is only single seller in the market.
- **Duopoly:** Duopoly is a form of market in which there are two firms having a complete control over the market.
- **Oligopoly:** Oligopoly is a form of market in which few firms have control over the market.
- **Competition:** Competition is a form of market in which there are large number buyers and sellers.

Monopolistic Competition:

Monopolistic competition is that market situation in which both monopoly and competition co-exist.

Profit:

Profit is the difference between total revenue and total cost.

- **Normal Profit:** AR = AC (or) TR = TC
- **Abnormal Profit:** AR > AC (or) TR > TC

Price Discrimination:

If producer or seller charges different price from different consumers of the same product is known as price discrimination.

Meetings of Company:

A meeting in which directors and shareholders decide the company's matter is called meeting of company;

- **BOD Meeting:** A meeting in which board of directors decide the company's matter.
- **Shareholders Meeting:** shareholders meeting is called to discuss the company's affairs with shareholders.
    - **Statutory Meeting:** The first meeting of shareholders of company.
    - **Annual General Meeting (AGM):** AGM is the annually meeting of shareholders in which annual performance of company is discussed.
    - **Extra-ordinary General Meeting:** The meeting which is conducted for particular and urgent nature of work which cannot be postponed till next AGM.

Resolution:

The formal expression of opinion obtained by the majority votes of members is known as resolution.

- **Ordinary Resolution:** A resolution which is passed by the simple majority of members.
- **Special Resolution:** A resolution which is passed by three fourth (3/4) majority of members.
- **Extra-ordinary Resolution:** A resolution which is passed by three fourth (3/4) majority of members on special notice of 14 days.

Co-operative Society:

Co-operative society is an association of persons who voluntarily pool their resources for mutual welfare of members.

Business Combination:

Business combination is the joining of two or more companies to form a single company for better business activities.

- **Horizontal Combination:** When two or more similar nature of business units are combined under one management is called horizontal combination.
- **Vertical Combination:** When two or more different nature of business units are combined under one management is vertical combination.

Difference between Amalgamation & Merger:

Amalgamation: When two or more existing companies lose their separate entity to form a new company is called amalgamation.

Merger:

When a company purchases the business of another company in which acquiring company retains its identity is called merger.