

Interview Preparation for the Post of Senior Auditors

Accounting

➤ **Accounting**

It is a systematic process of identifying, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial information. It reveals profit or loss for a given period, and the value and nature of a firm's assets, liabilities and owners' equity.

➤ **Types of Accounting**

- Financial accounting
- Cost accounting
- Management accounting
- Public accounting
- Government accounting
- Forensic accounting
- Tax accounting

➤ **Financial Accounting**

Financial accounting involves recording and classifying business transactions, and preparing and presenting financial statements to be used by *internal and external users*. In the preparation of financial statements, strict compliance with *generally accepted accounting principles* or GAAP is observed. Financial accounting is primarily concerned in processing *historical data*.

➤ **Management Accounting**

Managerial or management accounting focuses on providing information for use by *internal users*, the management. This branch deals with the needs of the management rather than strict compliance with generally accepted accounting principles. Managerial accounting involves financial analysis, budgeting and forecasting, cost analysis, evaluation of business decisions, and similar areas.

➤ **Cost Accounting**

Sometimes considered as a subset of management accounting, cost accounting refers to the recording, presentation, and analysis of *manufacturing costs*. Cost accounting is very useful in manufacturing businesses since they have the most complicated costing process. Cost accountants also analyze actual and standard costs to help managers determine future courses of action regarding the company's operations.

➤ **Public Accounting**

This field investigates the financial statements and supporting accounting systems of client companies, to provide assurance that the financial statements assembled by clients fairly present their financial results and position. This field requires excellent knowledge of the relevant accounting framework, as well as an inquiring personality that can delve into client systems as needed. The career track here is to progress through various audit staff positions to become an audit partner.

➤ **Government Accounting**

This field uses a unique accounting framework to create and manage funds, from which cash is disbursed to pay for a number of expenditures related to the provision of services by a government entity. Government accounting requires such a different skill set that accountants tend to specialize entirely within this area for their entire careers.

➤ **Forensic Accounting**

Forensic accounting involves court and litigation cases, fraud investigation, claims and dispute resolution, and other areas that involve legal matters. This is one of the popular trends in accounting today.

➤ **Tax Accounting**

Tax accounting helps clients follow rules set by tax authorities. It includes tax planning and preparation of tax returns. It also involves determination of income tax and other taxes, tax advisory services such as ways to minimize taxes legally, evaluation of the consequences of tax decisions, and other tax-related matters.

➤ **Users of Accounting**

Accounting information helps users to make better financial decisions. Users of financial information may be both internal and external to the organization.

Internal users (Primary Users) of accounting information include the following:

- **Management:** for analyzing the organization's performance and position and taking appropriate measures to improve the company results.
- **Employees:** for assessing company's profitability and its consequence on their future remuneration and job security.
- **Owners:** for analyzing the viability and profitability of their investment and determining any future course of action.

Accounting information is presented to internal users usually in the form of management accounts, budgets, forecasts and financial statements.

External users (Secondary Users) of accounting information include the following:

- **Creditors:** for determining the credit worthiness of the organization. Terms of credit are set by creditors according to the assessment of their customers' financial health. Creditors include suppliers as well as lenders of finance such as banks.
- **Tax Authorities:** for determining the credibility of the tax returns filed on behalf of the company.
- **Investors:** for analyzing the feasibility of investing in the company. Investors want to make sure they can earn a reasonable return on their investment before they commit any financial resources to the company.
- **Customers:** for assessing the financial position of its suppliers which is necessary for them to maintain a stable source of supply in the long term.
- **Regulatory Authorities:** for ensuring that the company's disclosure of accounting information is in accordance with the rules and regulations set in order to protect the interests of the stakeholders who rely on such information in forming their decisions.

➤ **Heads of Account**

• **Asset**

Things that are resources owned by a company and which have future economic value that can be measured and can be expressed in dollars. Examples include cash, investments, accounts receivable, inventory, supplies, land, buildings, equipment, and vehicles.

• **Expense**

An expense in accounting is the money spent or cost incurred in an entity's efforts to generate revenue. Expenses represent the cost of doing business where doing business is the sum total of the activities directed towards making a profit.

• **Liability**

A liability is a legally binding obligation payable to another entity. Liabilities are incurred in order to fund the ongoing activities of a business. Examples of liabilities are accounts payable, accrued expenses, wages payable, and taxes. These obligations are eventually settled through the transfer of cash or other assets to the other party. Liabilities expected to be settled within one year are classified as **current liabilities** on the balance sheet. All other liabilities are classified as **long-term liabilities**.

• **Income & Revenue**

Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants (IASB Framework).

Revenue is the amount of money that a company actually receives during a specific period, including discounts and deductions for returned merchandise. It is the "top line" or "gross income" figure from which costs are subtracted to determine net income.

• **Equity**

Equity is the net amount of funds invested in a business by its owners, plus any retained earnings. It is also calculated as the difference between the total of all recorded assets and liabilities on an entity's balance sheet.

➤ **Classification of Accounts**

Keeping in view the different type of transactions in a business firm, the accounts can be classified into following three categories:-

Personal Accounts:-

All the transactions relating to any person, company and firm, are called personal accounts. For example proprietor's capital account, bank accounts, insurance company's account, customers account, suppliers account etc.

Real Accounts:-

A real account is a general ledger account that does not close at the end of the accounting year. In other words, the balances in the real accounts are carried over to become the beginning balances of the next accounting period.

Generally, the real accounts are the balance sheet accounts. Balance sheet accounts are the asset accounts (cash, accounts receivable, buildings, etc.), liability accounts (notes payable, accounts payable, wages payable, etc.), and stockholders' equity accounts (common stock, retained earnings, etc.).

Nominal Accounts:-

All the income and expenditures accounts are called as nominal accounts. These are the accounts which can be recognized by name only but physically, nobody can touch or see them. For example: conveyance expenses, salaries, rent, interest, commission, discount, cartage etc.

➤ **Normal Loss**

The loss expected or anticipated prior to production is a normal process loss. It is thus called a standard loss. A provision for such a loss is made before starting production. Weight losses, shrinkage, evaporation, rusting etc. are the examples of normal loss.

➤ **Abnormal Loss**

The loss which is not happening in the ordinary course of business. It is an unanticipated loss. Abnormal loss is a controllable loss and thus can be avoided if corrective measures are taken. Arises because of abnormal working conditions, carelessness, rough handling, and lack of proper knowledge. Accident etc.

➤ **Expenditure**

An expenditure is a payment or disbursement. The expenditure may be for the purchase of an asset, a reduction of a liability, a distribution to the owners, or it could be an expense.

➤ **Direct expenses**

Direct, as the word suggests, are those expenses which are completely related or assigned to the core business operations. They are mainly related to purchases and production of goods/services. Direct expenses are a part of the prime cost or the cost of goods/services sold by a company. Direct expenses can differ for different types of companies, such as manufacturing companies, construction companies, service companies, etc.

➤ **Indirect expenses**

Unlike direct, indirect expenses are not directly related or assigned to the core business operations. Indirect expenses are necessary to keep the business up and running, but they can't be directly related to the cost of the core revenue generating goods/services. Indirect expenses can be different for different types of companies such as manufacturing, construction, service companies etc.

➤ **Types of Assets**

Current assets are expected to be consumed within one year, and commonly include the following line items:

- Cash and cash equivalents
- Marketable securities
- Prepaid expenses
- Accounts receivable
- Inventory

Non-current assets are also known as long-term assets, and are expected to continue to be productive for a business for more than one year. The line items usually included in this classification are:

- Tangible fixed assets
- Intangible fixed assets
- Goodwill

➤ **Tangible Assets**

A tangible asset is an asset that has a physical form. Tangible assets include both fixed assets, such as machinery, buildings and land, and current assets, such as inventory

➤ **Intangible Assets**

The opposite of a tangible asset is an intangible asset. Nonphysical assets, such as patents, trademarks, copyrights, goodwill and brand recognition, are all examples of intangible assets.

➤ **Fictitious assets**

Asset created by an accounting entry (and included under assets in the balance sheet) that has no tangible existence or realizable value but represents actual cash expenditure. The purpose of creating a fictitious asset is to account for expenses (such as those incurred in starting a business) that cannot be

placed under any normal account heading. Fictitious assets are written off as soon as possible against the firm's earnings.

➤ **Charts of Accounts**

A chart of accounts (COA) is a financial organizational tool that provides a complete listing of every account in an accounting system. An account is a unique record for each type of asset, liability, equity, revenue and expense.

➤ **System of Accounting**

There are two systems of Accounting:

Cash System of Accounting: This system records only cash receipts and payments. This system assumes that there are no credit transactions. In this system of accounting, expenses are considered only when they are paid and incomes are considered when they are actually received. This system is used by the organizations which are established for non-profit purpose. But this system is considered to be defective in nature as it does not show the actual profits earned and the current state of affairs of the organization.

Mercantile or Accrual System of Accounting: In this system, expenses and incomes are considered during that period to which they pertain. This system of accounting is considered to be ideal but it may result into unrealized profits which might reflect in the books of the accounts on which the organization have to pay taxes too. All the company forms of organization are legally required to follow Mercantile or Accrual System of Accounting.

➤ **Accounting Cycle**

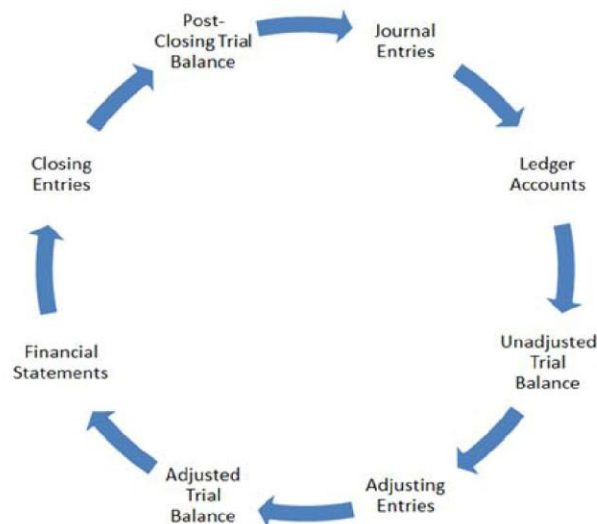
Accounting cycle is a step-by-step process of recording, classification and summarization of economic transactions of a business. It generates useful financial information in the form of financial statements including income statement, balance sheet, cash flow statement and statement of changes in equity.

Major Steps in Accounting Cycle

Following are the major steps involved in the accounting cycle. We will use a simple example problem to explain each step.

1. Analyzing and recording transactions via journal entries
2. Posting journal entries to ledger accounts
3. Preparing unadjusted trial balance
4. Preparing adjusting entries at the end of the period
5. Preparing adjusted trial balance
6. Preparing financial statements
7. Closing temporary accounts via closing entries
8. Preparing post-closing trial balance

Flow Chart



➤ **Accounting Principles**

There are general rules and concepts that govern the field of accounting. These general rules—referred to as basic accounting **principles and guidelines**—form the groundwork on which more detailed, complicated, and legalistic accounting rules are based. For example, the Financial Accounting Standards Board (FASB) uses the basic accounting principles and guidelines as a basis for their own detailed and comprehensive set of accounting rules and standards.

The phrase "generally accepted accounting principles" (or "GAAP") consists of three important sets of rules: (1) the basic accounting principles and guidelines, (2) the detailed rules and standards issued by

FASB and its predecessor the Accounting Principles Board (APB), and (3) the generally accepted industry practices. If a company distributes its financial statements to the public, it is required to follow generally accepted accounting principles in the preparation of those statements. Further, if a company's stock is publicly traded, federal law requires the company's financial statements be audited by independent public accountants. Both the company's management and the independent accountants must certify that the financial statements and the related notes to the financial statements have been prepared in accordance with GAAP. GAAP is exceedingly useful because it attempts to standardize and regulate accounting definitions, assumptions, and methods. Because of generally accepted accounting principles we are able to assume that there is consistency from year to year in the methods used to prepare a company's financial statements. And although variations may exist, we can make reasonably confident conclusions when comparing one company to another, or comparing one company's financial statistics to the statistics for its industry. Over the years the generally accepted accounting principles have become more complex because financial transactions have become more complex.

Since GAAP is founded on the basic accounting principles and guidelines, we can better understand GAAP if we understand those accounting principles. The following is a list of the ten main accounting principles and guidelines together with a highly condensed explanation of each.

1. Economic Entity Assumption

The accountant keeps all of the *business* transactions of a sole proprietorship separate from the business owner's *personal* transactions. For *legal* purposes, a sole proprietorship and its owner are considered to be one entity, but for accounting purposes they are considered to be two separate entities.

2. Monetary Unit Assumption

Economic activity is measured in U.S. dollars, and only transactions that can be expressed in U.S. dollars are recorded.

Because of this basic accounting principle, it is assumed that the dollar's purchasing power has not changed over time. As a result accountants ignore the effect of inflation on recorded amounts. For example, dollars from a 1960 transaction are combined (or shown) with dollars from a 2016 transaction.

3. Time Period Assumption

This accounting principle assumes that it is possible to report the complex and ongoing activities of a business in relatively short, distinct time intervals such as the five months ended May 31, 2016, or the 5 weeks ended May 1, 2016. The shorter the time interval, the more likely the need for the accountant to estimate amounts relevant to that period. For example, the property tax bill is received on December 15 of each year. On the income statement for the year ended December 31, 2015, the amount is known; but for the income statement for the three months ended March 31, 2016, the amount was not known and an estimate had to be used.

It is *imperative* that the time interval (or period of time) be shown in the heading of each income statement, statement of stockholders' equity, and statement of cash flows. Labeling one of these financial statements with "December 31" is not good enough—the reader needs to know if the statement covers the *one week* ended December 31, 2016 the *month* ended December 31, 2016 the *three months* ended December 31, 2016 or the *year ended* December 31, 2016.

4. Cost Principle

From an accountant's point of view, the term "cost" refers to the amount spent (cash or the cash equivalent) when an item was *originally* obtained, whether that purchase happened last year or thirty years ago. For this reason, the amounts shown on financial statements are referred to as *historical* cost amounts.

Because of this accounting principle asset amounts are *not* adjusted upward for inflation. In fact, as a general rule, asset amounts are not adjusted to reflect *any* type of increase in value. Hence, an asset amount does not reflect the amount of money a company would receive if it were to sell the asset at today's market value. (An exception is certain investments in stocks and bonds that are actively traded on a stock exchange.) If you want to know the current value of a company's long-term assets, you will not get this information from a company's financial statements—you need to look elsewhere, perhaps to a third-party appraiser.

5. Full Disclosure Principle

If certain information is important to an investor or lender using the financial statements, that information should be disclosed within the statement or in the notes to the statement. It is because of this basic accounting principle that numerous pages of "footnotes" are often attached to financial statements. As an example, let's say a company is named in a lawsuit that demands a significant amount of money. When the financial statements are prepared it is not clear whether the company will be able to defend

itself or whether it might lose the lawsuit. As a result of these conditions and because of the full disclosure principle the lawsuit will be described in the notes to the financial statements.

A company usually lists its significant accounting policies as the first note to its financial statements.

6. Going Concern Principle

This accounting principle assumes that a company will continue to exist long enough to carry out its objectives and commitments and will not liquidate in the foreseeable future. If the company's financial situation is such that the accountant believes the company will *not* be able to continue on, the accountant is required to disclose this assessment.

The going concern principle allows the company to defer some of its prepaid expenses until future accounting periods.

7. Matching Principle

This accounting principle requires companies to use the accrual basis of accounting. The matching principle requires that expenses be matched with revenues. For example, sales commission expense should be reported in the period when the sales were made (and not reported in the period when the commissions were paid). Wages to employees are reported as an expense in the week when the employees worked and not in the week when the employees are paid. If a company agrees to give its employees 1% of its 2016 revenues as a bonus on January 15, 2017, the company should report the bonus as an expense in 2016 and the amount unpaid at December 31, 2016 as a liability. (The expense is occurring as the sales are occurring.)

Because we cannot measure the future economic benefit of things such as advertisements (and thereby we cannot match the ad expense with related future revenues), the accountant charges the ad amount to expense in the period that the ad is run.

8. Revenue Recognition Principle or Realization

Under the accrual basis of accounting (as opposed to the cash basis of accounting), revenues are recognized as soon as a product has been sold or a service has been performed, regardless of when the money is actually received. Under this basic accounting principle, a company could earn and report \$20,000 of revenue in its first month of operation but receive \$0 in actual cash in that month. For example, if ABC Consulting completes its service at an agreed price of \$1,000, ABC should recognize \$1,000 of revenue as soon as its work is done—it does not matter whether the client pays the \$1,000 immediately or in 30 days. Do not confuse *revenue* with a cash receipt.

9. Materiality

Because of this basic accounting principle or guideline, an accountant might be allowed to violate another accounting principle if an amount is insignificant. Professional judgment is needed to decide whether an amount is insignificant or immaterial.

An example of an obviously immaterial item is the purchase of a \$150 printer by a highly profitable multi-million dollar company. Because the printer will be used for five years, the *matching* principle directs the accountant to expense the cost over the five-year period. The **materiality** guideline allows this company to violate the matching principle and to expense the entire cost of \$150 in the year it is purchased. The justification is that no one would consider it misleading if \$150 is expensed in the first year instead of \$30 being expensed in each of the five years that it is used.

Because of materiality, financial statements usually show amounts rounded to the nearest dollar, to the nearest thousand, or to the nearest million dollars depending on the size of the company.

10. Conservatism

If a situation arises where there are two acceptable alternatives for reporting an item, conservatism directs the accountant to choose the alternative that will result in less net income and/or less asset amount. Conservatism helps the accountant to "break a tie." It does not direct accountants to be conservative. Accountants are expected to be unbiased and objective.

The basic accounting principle of conservatism leads accountants to anticipate or disclose losses, but it does not allow a similar action for gains. For example, *potential* losses from lawsuits will be reported on the financial statements or in the notes, but *potential* gains will not be reported. Also, an accountant may write inventory *down* to an amount that is lower than the original cost, but will not write inventory *up* to an amount higher than the original cost.

11. Consistency principle

This is the concept that, once you adopt an accounting principle or method, you should continue to use it until a demonstrably better principle or method comes along. Not following the consistency principle means that a business could continually jump between different accounting treatments of its transactions that makes its long-term financial results extremely difficult to discern.

12. Prudence Concept

Accounting transactions and other events are sometimes uncertain but in order to be relevant we have to report them in time. We have to make estimates requiring judgment to counter the uncertainty. While making judgment we need to be cautious and prudent. Prudence is a key accounting principle which makes sure that assets and income are not overstated and liabilities and expenses are not understated

13. Dual Aspect Concept

Dual aspect is the foundation or basic principle of accounting. It provides the very basis for recording business transactions into the book of accounts. This concept states that every transaction has a dual or two-fold effect and should therefore be recorded at two places. In other words, at least two accounts will be involved in recording a transaction.

12. Accrual Concept

Accrual concept is the most fundamental principle of accounting which requires recording revenues when they are earned and not when they are received in cash, and recording expenses when they are incurred and not when they are paid. GAAP allows preparation of financial statements on accrual basis only (and not on cash basis). This is because under accrual concept revenues and expenses are recorded in the period to which they relate and not when they are received or paid. Application of accrual concept results in accurate reporting of net income, assets, liabilities and retained earnings which improves analysis of the company's financial performance and financial position over different periods. At the end of each reporting period, companies pass adjusting journal entries to record any accruals, for example accrual of utilities expense, interest expense, accrual of wages and salaries, adjustment of prepayments, etc.

13. Historical Cost Concept

Accounting is concerned with past events and it requires consistency and comparability that is why it requires the accounting transactions to be recorded at their historical costs. This is called historical cost concept.

Historical cost is the value of a resource given up or a liability incurred to acquire an asset/service at the time when the resource was given up or the liability incurred. In subsequent periods when there is appreciation in value, the value is not recognized as an increase in assets value except where allowed or required by accounting standards.

14. Relevance and Reliability

Relevance and reliability are two of the four key qualitative characteristics of financial accounting information. The others being understandability and comparability. Relevance requires that the financial accounting information should be such that the users need it and it is expected to affect their decisions. Reliability requires that the information should be accurate and true and fair. Relevance and reliability are both critical for the quality of the financial information, but both are related such that an emphasis on one will hurt the other and vice versa. Hence, we have to trade-off between them. Accounting information is relevant when it is provided in time, but at early stages information is uncertain and hence less reliable. But if we wait to gain while the information gains reliability, its relevance is lost.

15. Substance over form

Substance over form is an accounting principle which recognizes that business transactions should be accounted in accordance with their (economic) substance instead of their (legal) form. Economic substance refers to the underlying economic or commercial purpose of a business transaction apart from its legal or tax considerations. Legal form refers to interpretation of a business transaction in accordance with the applicable business laws.

While accounting for business transactions and other events, substance over form principle requires accountants to measure and present the economic impact of an event instead of its legal form. Substance over form approach is critical for preparation of true and fair financial statements. It is particularly relevant while accounting for revenues, sale and purchase agreements, leases etc. Substance over form principle is recognized by all major financial reporting frameworks, namely the International Financial Reporting Standards (IFRS) and US GAAP, etc. External auditors are required to attest that companies recognize all business transactions in compliance with the substance over form concept.

16. Understandability Concept

Understandability is one of the four qualitative characteristics of financial accounting information. The other being relevance, reliability, timeliness, faithful representation, comparability and materiality. Understandability refers to the quality of financial information which makes it understandable by people with reasonable background knowledge of business and economic activities.

Understandability requires the information presented in financial reports to be concise, complete and clear in presentation. The information should be presented so as to facilitate the user of the information.

However, understandability never prescribes any complex information to be omitted altogether due to its underlying difficulty in understanding. It just requires us to disclose the information systematically instead of presenting it haphazardly.

17. Comparability Principle

Comparability is one of the key qualities which accounting information must possess. Accounting information is comparable when accounting standards and policies are applied consistently from one period to another and from one region to another. The characteristic of comparability of financial statements is important because it allows us to compare a set of financial statements with those of prior periods and those of other companies.

➤ Depreciation

The monetary value of an asset decreases over time due to use, wear and tear or obsolescence. This decrease is measured as depreciation. Depreciation, i.e. a decrease in an asset's value, may be caused by a number of other factors as well such as unfavorable market conditions, etc. Machinery, equipment, currency are some examples of assets that are likely to depreciate over a specific period of time. Opposite of depreciation is appreciation which is increase in the value of an asset over a period of time. Accounting estimates the decrease in value using the information regarding the useful life of the asset. This is useful for estimation of property value for taxation purposes like property tax etc. For such assets like real estate, market and economic conditions are likely to be crucial such as in cases of economic downturn.

➤ Methods of Depreciation

• Straight Line Method

Also known as Original cost method, Fixed installment method and Fixed percentage method. The simplest, most used and popular method of charging depreciation is straight line method. An equal amount is allocated for each accounting period. The rate of depreciation is the reciprocal of the estimated useful life of an asset, so, for example, the useful life of an asset is 5 years, the depreciation charged will be $1/5 = 20\%$.

According to Straight Line Method,

Depreciation Amount = (Cost of asset – Salvage Value) / Useful life of **asset** in years

• Diminishing Value Method

Also known as Written down value method, Reducing installment method and fixed percentage on diminishing balance. According to the diminishing value method, depreciation is charged on reducing balance on a fixed rate. Depreciation, in this case, is charged over the useful life of an asset over its written down value. The percentage, at which depreciation is charged, remains fixed, however, the amount of depreciation goes on diminishing year after year. According to the Diminishing Value Method,

$$D = 1 - \sqrt[n]{\frac{r}{c}}$$

D = Depreciation %

n = Useful life of asset in years

r = residual value of asset

c = Cost of asset

• Annuity method

Under annuity method of depreciation the cost of asset is regarded as investment and interest at fixed rate is calculated thereon. Had the proprietor invested outside the business, an amount equal to the cost of asset, he would have earned some interest. So as a result of buying the asset the proprietor loses not only cost of asset by using it, but also the above mentioned interest. Hence depreciation is calculated in such a way as will cover both the above mentioned losses. The amount of annual depreciation is determined from annuity table. Annuity method is particularly applicable to those assets whose cost is heavy and life is long and fixed, e.g. leasehold property, land and building etc.

• Machine hour rate method

Under machine hour rate method, the total number of working hours of a machine during the whole of its effective life is estimated, and then, the cost of machine is divided by the expected number of hours of useful life, this gives the rate per hour. The annual depreciation is calculated by multiplying this rate by the number of hours, the machine actually runs in a year.

• Revaluation method

Under revaluation method of depreciation, the assets are revalued each year. The method is normally adapted to charge depreciation on numerous inexpensive fixed assets like small tools, livestock, patents, copy rights and other assets of such nature which are constantly changing and their period of life is most uncertain. Accordingly periodic inventory is taken of usable items and valued at cost irrespective of ruling prices. Excess of the opening over the closing inventory thus gives the periodic depreciation expenses

- **Sum-of-the-years' digit method**

Sum of the years' digits depreciation method involves calculating depreciation based on the sum of the number of years in an asset's useful life. Sum of the years' digits depreciation method, like reducing balance method, is a type of accelerated depreciation technique that allocates higher depreciation expense in the earlier years of an asset's useful life.

- **Salvage Value**

Also known as residual value; the remaining value of an asset after it has been fully depreciated.

- **Historical Cost**

The original monetary value of an economic item and based on the stable measuring unit assumption. Improvements may be added to an asset's cost.

- **Useful Life**

The length of time, typically in years, that an asset is expected to function and be useful.

- **Accumulated Depreciation**

Accumulated depreciation is the total depreciation for a fixed asset that has been charged to expense since that asset was acquired and made available for use. The accumulated depreciation account is an asset account with a credit balance (also known as a contra asset account); this means that it appears on the balance sheet as a reduction from the gross amount of fixed assets reported.

- **Amortization**

Amortization is an accounting term that refers to the process of allocating the cost of an intangible asset over a period of time. It also refers to the repayment of loan principal over time.

- **Financial Statements**

Financial Statements represent a formal record of the financial activities of an entity. These are written reports that quantify the financial strength, performance and liquidity of a company. Financial Statements reflect the financial effects of business transactions and events on the entity.

Four Types of Financial Statements

The four main types of financial statements are:

1. Statement of Financial Position

Statement of Financial Position, also known as the Balance Sheet, presents the financial position of an entity at a given date. It is comprised of the following three elements:

- **Assets:** Something a business owns or controls (e.g. cash, inventory, plant and machinery, etc.)
- **Liabilities:** Something a business owes to someone (e.g. creditors, bank loans, etc.)
- **Equity:** What the business owes to its owners. This represents the amount of capital that remains in the business after its assets are used to pay off its outstanding liabilities. Equity therefore represents the difference between the assets and liabilities.

2. Income Statement

Income Statement, also known as the *Profit and Loss Statement*, reports the company's financial performance in terms of net profit or loss over a specified period. Income Statement is composed of the following two elements:

- **Income:** What the business has earned over a period (e.g. sales revenue, dividend income, etc.)
- **Expense:** The cost incurred by the business over a period (e.g. salaries and wages, depreciation, rental charges, etc.) Net profit or loss is arrived by deducting expenses from income.

3. Cash Flow Statement

Cash Flow Statement, presents the movement in cash and bank balances over a period. The movement in cash flows is classified into the following segments:

- **Operating Activities:** Represents the cash flow from primary activities of a business.
- **Investing Activities:** Represents cash flow from the purchase and sale of assets other than inventories (e.g. purchase of a factory plant)
- **Financing Activities:** Represents cash flow generated or spent on raising and repaying share capital and debt together with the payments of interest and dividends.

4. Statement of Changes in Equity

Statement of Changes in Equity, also known as the *Statement of Retained Earnings*, details the movement in owners' equity over a period. The movement in owners' equity is derived from the following components:

- Net Profit or loss during the period as reported in the income statement
- Share capital issued or repaid during the period
- Dividend payments
- Gains or losses recognized directly in equity (e.g. revaluation surpluses)
- Effects of a change in accounting policy or correction of accounting error

➤ Fund flow Statement

Fund Flow statement is a statement that shows the ups and downs of the financial position or the changes in working capital of the entity between the two financial years.

➤ Contingent Liability

A contingent liability is a potential liability that may occur, depending on the outcome of an uncertain future event. A contingent liability is recorded in the accounting records if the contingency is probable and the amount of the liability can be reasonably estimated.

➤ Contingent Asset

A contingent asset is a possible asset that may arise because of a gain that is contingent on future events that are not under an entity's control. According to the accounting standards, a business does not recognize a contingent asset even if the associated contingent gain is probable.

➤ Disclosure

A disclosure is additional information attached to an entity's financial statements, usually as explanation for activities which have significantly influenced the entity's financial results.

➤ Financial Ratio Analysis

Financial ratio analysis is performed by comparing two items in the financial statements. The resulting ratio can be interpreted in a way that is not possible when interpreting the items separately. Financial ratios can be classified into ratios that measure: profitability, liquidity, management efficiency, leverage, and valuation & growth.

List of Financial Ratios

Here is a list of various financial ratios. Take note that most of the ratios can also be expressed in *percentage* by multiplying the decimal number by 100%. Each ratio is briefly described.

Profitability Ratios

Profitability ratios measure the ability of a business to earn profit for its owners. While liquidity ratios and solvency ratios explain the financial position of a business, profitability ratios and efficiency ratios communicate the financial performance of a business. Important profitability ratios include:

1. Gross Profit Rate = Gross Profit / Net Sales

Evaluates how much gross profit is generated from sales. Gross profit is equal to net sales (*sales minus sales returns, discounts, and allowances*) minus cost of sales.

2. Return on Sales = Net Income / Net Sales

Also known as "net profit margin" or "net profit rate", it measures the percentage of income derived from dollar sales. Generally, the higher the ROS the better.

3. Return on Assets = Net Income / Average Total Assets

In financial analysis, it is the measure of the *return on investment*. ROA is used in evaluating management's efficiency in using assets to generate income.

4. Return on Stockholders' Equity = Net Income / Average Stockholders' Equity

Measures the percentage of income derived for every dollar of owners' equity.

Liquidity Ratios

Liquidity ratios assess a business's liquidity, i.e. its ability to convert its assets to cash and pay off its obligations without any significant difficulty (i.e. delay or loss of value). Liquidity ratios are particularly useful for suppliers, employees, banks, etc. Important liquidity ratios are:

1. Current Ratio = Current Assets / Current Liabilities

Evaluates the ability of a company to pay short-term obligations using current assets (cash, marketable securities, current receivables, inventory, and prepayments).

2. Acid Test Ratio = Quick Assets / Current Liabilities

Also known as "*quick ratio*", it measures the ability of a company to pay short-term obligations using the more liquid types of current assets or "quick assets" (cash, marketable securities, and current receivables).

3. Cash Ratio = (Cash + Marketable Securities) / Current Liabilities

Measures the ability of a company to pay its current liabilities using cash and marketable securities. Marketable securities are short-term debt instruments that are as good as cash.

4. Net Working Capital = Current Assets - Current Liabilities

Determines if a company can meet its current obligations with its current assets; and how much excess or deficiency there is.

Management Efficiency Ratios/ Activity Ratio

Activity ratios assess the efficiency of operations of a business. For example, these ratios attempt to find out how effectively the business is converting inventories into sales and sales into cash, or how it is utilizing its fixed assets and working capital, etc. Key activity ratios are:

1. Receivable Turnover = Net Credit Sales / Average Accounts Receivable

Measures the efficiency of extending credit and collecting the same. It indicates the average number of times in a year a company collects its open accounts. A high ratio implies efficient credit and collection process.

2. Days Sales Outstanding = 360 Days / Receivable Turnover

Also known as "*receivable turnover in days*", "*collection period*". It measures the average number of days it takes a company to collect a receivable. The shorter the DSO, the better. Take note that some use 365 days instead of 360.

3. Inventory Turnover = Cost of Sales / Average Inventory

Represents the number of times inventory is sold and replaced. Take note that some authors use Sales in lieu of Cost of Sales in the above formula. A high ratio indicates that the company is efficient in managing its inventories.

4. Days Inventory Outstanding = 360 Days / Inventory Turnover

Also known as "*inventory turnover in days*". It represents the number of days inventory sits in the warehouse. In other words, it measures the number of days from purchase of inventory to the sale of the same. Like DSO, the shorter the DIO the better.

5. Accounts Payable Turnover = Net Credit Purchases / Ave. Accounts Payable

Represents the number of times a company pays its accounts payable during a period. A low ratio is favored because it is better to delay payments as much as possible so that the money can be used for more productive purposes.

6. Days Payable Outstanding = 360 Days / Accounts Payable Turnover

Also known as "*accounts payable turnover in days*", "*payment period*". It measures the average number of days spent before paying obligations to suppliers. Unlike DSO and DIO, the longer the DPO the better (as explained above).

7. Operating Cycle = Days Inventory Outstanding + Days Sales Outstanding

Measures the number of days a company makes 1 complete operating cycle, i.e. purchase merchandise, sell them, and collect the amount due. A shorter operating cycle means that the company generates sales and collects cash faster.

8. Cash Conversion Cycle = Operating Cycle - Days Payable Outstanding

CCC measures how fast a company converts cash into more cash. It represents the number of days a company *pays* for purchases, sells them, and collects the amount due. Generally, like operating cycle, the shorter the CCC the better.

9. Total Asset Turnover = Net Sales / Average Total Assets

Measures overall efficiency of a company in generating sales using its assets. The formula is similar to ROA, except that net sales is used instead of net income.

Leverage Ratios

A leverage ratio is any one of several financial measurements that look at how much capital comes in the form of debt (loans), or assesses the ability of a company to meet financial obligations.

1. Debt Ratio = Total Liabilities / Total Assets

Measures the portion of company assets that is financed by debt (obligations to third parties). Debt ratio can also be computed using the formula: 1 minus *Equity Ratio*.

2. Equity Ratio = Total Equity / Total Assets

Determines the portion of total assets provided by equity (i.e. owners' contributions and the company's accumulated profits). Equity ratio can also be computed using the formula: 1 minus *Debt Ratio*.

The reciprocal of equity ratio is known as *equity multiplier*, which is equal to total assets divided by total equity.

3. Debt-Equity Ratio = Total Liabilities / Total Equity

Evaluates the capital structure of a company. A D/E ratio of more than 1 implies that the company is a leveraged firm; less than 1 implies that it is a conservative one.

4. Times Interest Earned = EBIT / Interest Expense

Measures the number of times interest expense is converted to income, and if the company can pay its interest expense using the profits generated. EBIT is earnings before interest and taxes.

Valuation and Growth Ratios

A valuation ratio is any one of several calculations that determines whether a particular security is cheap or expensive when compared to a certain measure, such as profits or enterprise value. In other words, valuation ratio helps an investor to determine the cost of an investment with respect to the value or benefits of owning that investment.

1. Earnings per Share = (Net Income - Preferred Dividends) / Average Common Shares Outstanding

EPS shows the rate of earnings per share of common stock. Preferred dividends is deducted from net income to get the earnings available to common stockholders.

2. Price-Earnings Ratio = Market Price per Share / Earnings per Share

Used to evaluate if a stock is over- or underpriced. A relatively *low P/E ratio* could indicate that the company is underpriced. Conversely, investors expect high growth rate from companies with *high P/E ratio*.

3. Dividend Pay-out Ratio = Dividend per Share / Earnings per Share

Determines the portion of net income that is distributed to owners. Not all income is distributed since a significant portion is retained for the next year's operations.

4. Dividend Yield Ratio = Dividend per Share / Market Price per Share

Measures the percentage of return through dividends when compared to the price paid for the stock. A high yield is attractive to investors who are after dividends rather than long-term capital appreciation.

5. Book Value per Share = Common SHE / Average Common Shares

Indicates the value of stock based on historical cost. The value of common shareholders' equity in the books of the company is divided by the average common shares outstanding.

Solvency Ratio

Solvency ratios assess the long-term financial viability of a business i.e. its ability to pay off its long-term obligations such as bank loans, bonds payable, etc. Information about solvency is critical for banks, employees, owners, bond holders, institutional investors, government, etc. Key solvency ratios are:

1. Debt ratio

Debt ratio (also known as debt to assets ratio) is a ratio which measures debt level of a business as a percentage of its total assets. It is calculated by dividing total debt of a business by its total assets. Debt ratio finds out the percentage of total assets that are financed by debt and helps in assessing whether it is sustainable or not. If the percentage is too high, it might indicate that it is too difficult for the business to pay off its debts and continue operations.

Debt ratio is calculated using the following formula:

$$\text{Debt Ratio} = \frac{\text{Total Debt}}{\text{Total Assets}}$$

Total debt equals long-term debt and short-term debt. It is not equivalent to total liabilities because it excludes non-debt liabilities such as accounts payable, salaries payable, etc.

Total assets include both current assets and non-current assets.

Sometimes, debt ratio is calculated based on the total liabilities instead of total debt.

2. Debt to equity ratio

Debt-to-Equity ratio is the ratio of total liabilities of a business to its shareholders' equity. It is a leverage ratio and it measures the degree to which the assets of the business are financed by the debts and the shareholders' equity of a business.

Debt-to-equity ratio is calculated using the following formula:

$$\text{Debt-to-Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Shareholders' Equity}}$$

Both total liabilities and shareholders' equity figures in the above formula can be obtained from the balance sheet of a business. A variation of the above formula uses only the interest bearing long-term liabilities in the numerator.

3. Debt to capital ratio

Debt-to-capital ratio is a solvency ratio that measures the proportion of interest-bearing debt to the sum of interest-bearing debt and shareholders' equity.

Interest-bearing debt includes bonds payable, bank loans, notes payable, etc. Non-interest bearing debt includes trade payable, accrued expenses, etc.

The debt-to-capital ratio is a refinement of the debt-to-assets ratio. It measures how much of the capital employed (i.e. the resources on which the company pays a cost) is debt. Higher debt included in the capital employed means higher risk of insolvency.

$$\text{Debt-to-Capital Ratio} = \frac{\text{Interest-bearing Debt}}{\text{Interest-bearing Debt} + \text{Shareholders' Equity}}$$

4. Times interest earned ratio

Times interest earned ratio (also called interest coverage ratio) is an indicator of the company's ability to pay off its interest expense with available earnings. It is a measure of a company's solvency, i.e. its long-term financial strength. It calculates how many times a company's operating income (earnings before interest and taxes) can settle the company's interest expense. A higher times interest earned ratio indicates that the company's interest expense is low relative to its earnings before interest and taxes (EBIT) which indicates better long-term financial strength, and vice versa.

Time interest earned ratio is calculated by dividing earnings before interest and tax (EBIT) for a period with

Interest expense for the period as follows:

$$\text{Times Interest Earned} = \frac{\text{Earnings before Interest and Tax}}{\text{Interest Expense}}$$

Both figures in the above formula can be obtained from the income statement of a company. Earnings before interest and taxes (EBIT) is used in the formula because generally a company can pay off all of its interest expense before incurring any income tax expense.

The ratio is reported as a number instead of a percentage.

5. Fixed charge coverage ratio

Fixed charge coverage is a solvency ratio that measures whether earnings before interest, taxes and lease payments are sufficient to cover the interest and lease payments. It is calculated by dividing the sum of earnings before interest and taxes and lease payments by the sum of interest payments and lease payments.

Fixed charge coverage ratio is very similar to interest coverage ratio. The only difference is that fixed charge coverage ratio takes into account the annual obligations on account of lease payments too (in addition to interest payments).

The higher the ratio, the better is the solvency situation of the company. The ratio is best used together with other solvency ratios such debt ratio, financial leverage ratio, etc.

$$\text{Fixed Charge Coverage} = \frac{\text{EBIT} + \text{Lease Payments other than Interest Portion}}{\text{Interest Payments} + \text{Lease Payments}}$$

6. Equity multiplier

Equity multiplier is a financial leverage ratio which is calculated by dividing total assets by the shareholders equity. It tells about assets in dollar per dollar of equity. The higher the ratio the lower the financial leverage and the lower the ratio the higher the financial leverage.

$$\text{Equity Multiplier} = \frac{\text{Total Assets}}{\text{Total Equity}}$$

Equity multiplier is an important input in the DuPont return on equity analysis. DuPont return on equity analysis breaks up ROE into net profit margin, asset turnover and financial leverage (represented by equity multiplier as shown below:

$$\begin{matrix} \text{ROE Under} & & \text{Net} & & \text{Sales} & & \text{Total} & & \text{Net} \\ \text{DuPont} & & \text{Income} & & & & \text{Assets} & & \text{Income} \\ \text{Analysis} = & \frac{}{\text{Sales}} & \times & \frac{}{\text{Total Assets}} & \times & \frac{}{\text{Total Equity}} & = & \frac{}{\text{Total Equity}} \end{matrix}$$

Higher equity multiplier leads to a higher return on equity.

➤ **Accounting adjustments**

Adjusting entries are journal entries made at the end of an accounting period that allocate income and expenses to their proper period. For accounting purposes, adjusting entries are journal entries made at the end of an accounting period. Adjusting entries allocate income and/or expenses to the period in which they actually occurred. The revenue recognition principle states that income and expenses must match. This is why adjusting entries need to be made under an accrual based accounting system. Based on this, revenues and associated costs are recognized in the same accounting period. However, the actual cash may be received or paid at a different time.

The Types of Adjusting Entries

There are several different types of adjusting entries. Each one accounts for a different situation.

Prepayments - adjusting entries for prepayments are necessary to account for cash that has been paid prior to delivery of goods or completion of services. When this cash is paid, it is first recorded in a prepaid expense asset account; the account is to be expensed either with the passage of time (e.g. rent, insurance) or through use and consumption (e.g. supplies). The adjusting entry would credit the asset (e.g. supplies) account and debit a related expense account (e.g. supplies expense)

Accruals - accrued revenues are revenues that have been recognized (that is, services have been performed or goods have been delivered), but their cash payment have not yet been recorded or received. When the revenue is recognized, it is recorded as a receivable. Accrued expenses have not yet been paid for, so they are recorded in a payable account. Expenses for interest, taxes, rent, and salaries are commonly accrued for reporting purposes.

Accounting method that records revenues and expenses when they are incurred, regardless of when cash is exchanged. The term "accrual" refers to any individual entry recording revenue or expense in the absence of a cash transaction.

Estimates - An adjusting entry for an estimate occurs when the exact amount of an expense cannot easily be determined. For example, the depreciation of fixed assets is an expense that has to be estimated. The entry for bad debt expense can also be classified as an estimate.

Inventory - in a periodic inventory system, an adjusting entry is used to determine the cost of goods sold expense. This entry is not necessary for a company using perpetual inventory.

➤ **Closing Entries**

Closing entries, also called closing journal entries, are entries made at the end of an accounting period to zero out all temporary accounts and transfer their balances to permanent accounts. In other words, the temporary accounts are closed or reset at the end of the year.

➤ **Deferrals**

In accounting this means to defer or to delay recognizing certain revenues or expenses on the income statement until a later, more appropriate time. Revenues are deferred to a balance sheet liability account until they are earned in a later period.

➤ **Appropriation**

Appropriation is the act of setting aside money for a specific purpose. A company or a government appropriates funds in order to delegate cash for the necessities of its business operations.

➤ **Appropriation Accounts**

In **General accounting** an appropriation account shows the various ways that company funds have been used. For example funds may have been split between investment, tax payments, making external loans or distribution of dividends.

In **Public accounting** an appropriation account is a governmental accounting term.

The appropriation account is the account of any governmental agency that receives a credit. An appropriation account is reduced by the costs incurred by the agency to perform the task or complete the project for which the credit was given.

➤ **Re-appropriation of Funds**

Whenever the budget is announced every year in the month of June every department gives the statement of expenditure and expenses to the finance division in a particular Performa under different heads. For example there may be one head of salaries and establishments the other head development expenditure there may be another head of non-development expenditure. Finance division gives grants to the departments according to these heads provided by the department. Since the budget is announced only once in a year, all the heads have been allocated the funds, now there may arise a situation in the end of the financial year or in the middle of financial year for another purpose which is not legally restricted by the finance division and also the department is not in a position to put off this expense until next budget then in order to meet such and unexpected or immediate expense RE APPROPRIATION is done that is by the approval of the head of the department the excess of any of the head is transferred to the head in which the expenditure has to be made.

➤ **Supplementary Grant**

The process of re appropriation above this process occur only when the department has sufficient funds in one of the heads and no funds in the other head under which the expenditure has to be made. But there may come a situation that the re appropriation may not be done due to non-availability of funds. In such a situation the department submits a requisition to the national assembly through the finance division to give some extra amount to them which was in excess to the already approved budget of the department. This extra demand is debated and voted in the national assembly and this is called SUPPLEMENTARY GRANT

➤ **Deferred Tax Liability**

A deferred tax liability is an account on a company's balance sheet that is a result of temporary differences between the company's accounting and tax carrying values, the anticipated and enacted income tax rate, and estimated taxes payable for the current year. This liability may be realized during any given year, which makes the deferred status appropriate. Because there are differences between what a company can deduct for tax and accounting purposes, there is a difference between a company's taxable income and income before tax. A deferred tax liability records the fact the company will, in the future, pay more income tax because of a transaction that took place during the current period, such as an installment sale receivable.

➤ **Deferred Tax Asset**

Deferred tax asset is an accounting term that refers to a situation where a business has overpaid taxes or taxes paid in advance on its balance sheet. These taxes are eventually returned to the business in the form of tax relief, and the over-payment is, therefore, an asset for the company. A deferred tax asset can conceptually be compared to rent paid in advance or refundable insurance premiums; while the business no longer has cash on hand, it does have comparable value, and this must be reflected in its financial statements.

➤ **Lease**

A lease is usually a written agreement between an owner of property (land, building, equipment, vehicle, etc.) and a person or business that will use the property for a stated period of time at a specified series of payments. The owner of the property is known as the lessor and the person using the property is the lessee.

IAS 17 *Leases* prescribes the accounting policies and disclosures applicable to leases, both for lessees and lessors. Leases are required to be classified as either finance leases (which transfer substantially all the risks and rewards of ownership, and give rise to asset and liability recognition by the lessee and a receivable by the lessor) and operating leases (which result in expense recognition by the lessee, with the asset remaining recognized by the lessor).

➤ **Sinking fund**

A sinking fund is a means of repaying funds borrowed through a bond issue through periodic payments to a trustee who retires part of the issue by purchasing the bonds in the open market. Rather than the issuer repaying the entire principal of a bond issue on the maturity date, another company buys back a portion of the issue annually and usually at a fixed par value or at the current market value of the bonds, whichever is less.

➤ **FSA (Financial Statement Analysis) Techniques**

Financial statement analysis can be performed by employing a number of methods or techniques. The following are the important methods or techniques of financial statement analysis.

1. Ratio Analysis

Ratio analysis is the analysis of the interrelationship between two financial figures.

2. Cash Flow Analysis

Cash flow analysis is the analysis of the change in the cash position during a period.

3. Comparative Financial Statements

Comparative financial statement is a analysis of financial statements of the company for two years or of the two companies of similar types.

4. Trend Analysis

Trend analysis is the analysis of the trend of the financial ratios of the company over the years.

The methods to be selected for the analysis depend upon the circumstances and the users' need. The user or the analyst should use appropriate methods to derive required information to fulfill their needs.

➤ **What are techniques/ tools of management accounting analysis?**

Some of the important tools and techniques are briefly explained below.

1. **Financial Planning:** The main objective of any business organization is maximization of profits. This objective is achieved by making proper or sound financial planning. Hence, financial planning is considered as best tool for achieving business objectives.

2. **Financial Statement Analysis:** Profit and Loss account and Balance Sheet are important financial statements. These statements are analyzed for different period. This type of analysis helps the management to know the rate of growth of business concern. This analysis is done through comparative financial statements, common size statements and ratio analysis.

3. **Cost Accounting:** Cost accounting presents cost data in product wise, process wise, department wise, branch wise and the like. These cost data are compared with predetermined one. This comparison of two costs enables the management to decide the reasons responsible for the difference between these costs.

4. **Fund Flow Analysis:** This analysis find out the movement of fund from one period to another. Moreover, this analysis is very useful to know whether the fund is properly used or not in a year when compared to the previous year. The working capital changes and funds from operation are also find out through this analysis.

5. **Cash Flow Analysis:** The movement of cash from one period to another can be find out through this analysis. Besides, the reasons for cash balance and changes between two periods are also find out. It studies the cash from operation and the movement of cash in a period.

6. **Standard Costing:** Standard costing is predetermined cost. It provides a yard stick for measuring actual performance. It is used to find the reasons for the deviations if any.

7. **Marginal Costing:** Marginal costing technique is used to fix the selling price, selection of best sales mix, best use of scarce raw materials or resources, to take make or buy decision, acceptance or rejection of bulk order and foreign order and the like. This is based on the fixed cost, variable cost and contribution.

8. **Budgetary Control:** Under Budgetary control techniques, future financial needs are estimated and arranged according to an orderly basis. It is used to control the financial performances of business concern. Business operations are directed in a desired direction.

9. **Revaluation Accounting:** The fixed assets are revalued as per the revaluation accounting method so that the capital is properly represented with the assets value. It helps to find out the fair return on capital employed.

10. **Decision-making Accounting:** A business problem can be solved by choosing any one of the best and most profitable alternative. To select such alternative, the relevant costs are compared. Thus, accounting information are used to solve the business problem which are arising out of increasing complexity of nature of business.

11. **Management Information System:** The free flow communication within the organization is essential for effective functioning of business. Hence, the management can design the system through which every employee of an organization can assess the information and used for discharging their duties and taking quality decisions.

12. **Statistical Techniques:** There are a lot of statistical techniques used in removing management problems. Methods of least square, regression and quality control etc. are some examples of statistical techniques.

13. **Management Reporting:** The management accountant is preparing the report on the basis of the contents of profit and loss account and balance sheet and submit the same before the top management. Thus prepared reports disclose the strength and weakness indifferent areas of operating activities and financial activities. These identification are highly useful to management for exercising control and decision-making.

14. **Historical Cost Accounting:** It means that costs are recorded after being incurred. This is used for comparing with predetermined costs to evaluate performance.

15. **Ratio Analysis:** It is used to management in the discharge of its basic functions of forecasting, planning, coordination, communication and control. It paves the way for effective control of business operations by undertaking an appraisal of both the physical and monetary targets.

➤ **Costing Techniques**

Besides the methods of costing, following are the types of costing techniques which are used by management only for controlling costs and making some important managerial decisions. As a matter of fact, they are not independent methods of cost finding such as job or process costing but are basically costing techniques which can be used as an advantage with any of the methods discussed above.

1. Marginal Costing

Marginal costing is a technique of costing in which allocation of expenditure to production is restricted to those expenses which arise as a result of production, e.g., materials, labor, direct expenses and variable overheads. Fixed overheads are excluded in cases where production varies because it may give misleading results. The technique is useful in manufacturing industries with varying levels of output.

2. Direct Costing

The practice of charging all direct costs to operations, processes or products and leaving all indirect costs to be written off against profits in the period in which they arise is termed as direct costing. The technique differs from marginal costing because some fixed costs can be considered as direct costs in appropriate circumstances.

3. Absorption or Full Costing

The practice of charging all costs both variable and fixed to operations, products or processes is termed as absorption costing.

4. Uniform Costing

A technique where standardized principles and methods of cost accounting are employed by a number of different companies and firms is termed as uniform costing. Standardization may extend to the methods of costing, accounting classification including codes, methods of defining costs and charging depreciation, methods of allocating or apportioning overheads to cost centers or cost units. The system, thus, facilitates inter- firm comparisons, establishment of realistic pricing policies, etc.

Systems of Costing

It has already been stated that there are two main methods used to determine costs. These are:

- Job cost method
- Process cost method

It is possible to ascertain the costs under each of the above methods by two different ways:

- Historical costing
- Standard costing

Historical Costing

Historical costing can be of the following two types in nature:

- Post costing
- Continuous costing

Post Costing

Post costing means ascertainment of cost after the production is completed. This is done by analyzing the financial accounts at the end of a period in such a way so as to disclose the cost of the units which have been produced.

For instance, if the cost of product A is to be calculated on this basis, one will have to wait till the materials are actually purchased and used, labor actually paid and overhead expenditure actually incurred. This system is used only for ascertaining the costs but not useful for exercising any control over costs, as one comes to know of things after they had taken place. It can serve as

Guidance for future production only when conditions in future continue to be the same.

Continuous Costing

In case of this method, cost is ascertained as soon as a job is completed or even when a job is in progress. This is done usually before a job is over or product is made. In the process, actual expenditure on materials and wages and share of overheads are also estimated. Hence, the figure of cost ascertained in this case is not exact. But it has an advantage of providing cost information to the management promptly, thereby enabling it to take necessary corrective action on time. However, it neither provides any standard for judging current efficiency nor does it disclose what the cost of a job ought to have been.

Standard Costing

Standard costing is a system under which the cost of a product is determined in advance on certain pre-determined standards. With reference to the example given in post costing, the cost of product A can be calculated in advance if one is in a position to estimate in advance the material labor and overheads that should be incurred over the product. All this requires an efficient system of cost accounting. However, this system will not be useful if a vigorous system of controlling costs and standard costs are not in force. Standard costing is becoming more and more popular nowadays.

➤ **Consignment account**

Consignment occurs when goods are sent by their owner (the consignor) to an agent (the consignee), who undertakes to sell the goods. The consignor continues to own the goods until they are sold, so the goods appear as inventory in the accounting records of the consignor, not the consignee.

➤ **Bank reconciliation statement**

A bank reconciliation is the process of matching the balances in an entity's accounting records for a cash account to the corresponding information on a bank statement. The goal of this process is to ascertain the differences between the two, and to book changes to the accounting records as appropriate.

➤ **PPE (Property, Plant and Equipment), Why its valuation is based on cost?**

IAS 16 Property, Plant and Equipment outlines the accounting treatment for most types of property, plant and equipment. Property, plant and equipment is initially measured at its cost, subsequently measured either using a cost or revaluation model, or depreciated so that its depreciable amount is allocated on a systematic basis over its useful life.

➤ **Retained Earning**

Retained earnings refer to the percentage of net earnings not paid out as dividends, but retained by the company to be reinvested in its core business, or to pay debt. It is recorded under shareholders' equity on the balance sheet.

➤ **Capital Budgeting**

Capital budgeting is a process used by companies for evaluating and ranking potential expenditures or investments that are significant in amount. The large expenditures could include the purchase of new equipment, rebuilding existing equipment, purchasing delivery vehicles, constructing additions to buildings, etc. The large amounts spent for these types of projects are known as capital expenditures. Capital budgeting usually involves the calculation of each project's future accounting profit by period, the cash flow by period, the present value of the cash flows after considering the time value of money, the number of years it takes for a project's cash flow to pay back the initial cash investment, an assessment of risk, and other factors.

Capital budgeting is a tool for maximizing a company's future profits since most companies are able to manage only a limited number of large projects at any one time.

➤ **Payback Period**

The payback period is the length of time required to recover the cost of an investment. The payback period of a given investment or project is an important determinant of whether to undertake the position or project, as longer payback periods are typically not desirable for investment positions. The payback period ignores the time value of money, unlike other methods of capital budgeting, such as net present value, internal rate of return or discounted cash flow.

The payback period is expressed in years and fractions of years. For example, if a company invests \$300,000 in a new production line, and the production line then produces cash flow of \$100,000 per year, then the payback period is 3.0 years ($\$300,000 \text{ initial investment} / \$100,000 \text{ annual payback}$). An investment with a shorter payback period is considered to be better, since the investor's initial outlay is at risk for a shorter period of time. The calculation used to derive the payback period is called the payback method. The formula for the payback method is simplistic: Divide the cash outlay (which is assumed to occur entirely at the beginning of the project) by the amount of net cash flow generated by the project per year (which is assumed to be the same in every year).

➤ **Discounted Payback Period**

One of the major disadvantages of simple payback period is that it ignores the time value of money. To counter this limitation, an alternative procedure called discounted payback period may be followed, which accounts for time value of money by discounting the cash inflows of the project.

➤ **NPV**

Net present value (NPV) of a project is the potential change in an investor's wealth caused by that project while time value of money is being accounted for. It equals the present value of net cash inflows generated by a project less the initial investment on the project. It is one of the most reliable measures used in capital budgeting because it accounts for time value of money by using discounted cash flows in the calculation.

Net present value calculations take the following two inputs:

- Projected net cash flows in successive periods from the project.
- A target rate of return i.e. the hurdle rate.

Where,

Net cash flow equals total cash inflow during a period, including salvage value if any, less cash outflows from the project during the period.

Hurdle rate is the rate used to discount the net cash inflows. Weighted average cost of capital (WACC) is the most commonly used hurdle rate.

➤ **WACC. How to calculate WACC?**

Weighted average cost of capital (WACC) is a calculation of a firm's cost of capital in which each category of capital is proportionately weighted.

All sources of capital, including common stock, preferred stock, bonds and any other long-term debt, are included in a WACC calculation. A firm's WACC increases as the beta and rate of return on equity increase, as an increase in WACC denotes a decrease in valuation and an increase in risk.

To calculate WACC, multiply the cost of each capital component by its proportional weight and take the sum of the results. The method for calculating WACC can be expressed in the following formula:

$$WACC = \frac{E}{V} * Re + \frac{D}{V} * Rd * (1 - Tc)$$

Where:

Re = cost of equity

Rd = cost of debt

E = market value of the firm's equity

D = market value of the firm's debt

V = E + D = total market value of the firm's financing (equity and debt)

E/V = percentage of financing that is equity

D/V = percentage of financing that is debt

Tc = corporate tax rate

➤ **Accounting Rate of Return**

Accounting rate of return (also known as simple rate of return) is the ratio of estimated accounting profit of a project to the average investment made in the project. ARR is used in investment appraisal.

➤ **IRR**

Internal rate of return (IRR) is the discount rate at which the net present value of an investment becomes zero. In other words, IRR is the discount rate which equates the present value of the future cash flows of an investment with the initial investment. It is one of the several measures used for investment appraisal.

Decision Rule

A project should only be accepted if its IRR is NOT less than the target internal rate of return. When comparing two or more mutually exclusive projects, the project having highest value of IRR should be accepted.

➤ **Profitability Index**

Profitability index is an investment appraisal technique calculated by dividing the present value of future cash flows of a project by the initial investment required for the project.

➤ **MIRR**

Modified internal rate of return (MIRR) assumes that positive cash flows are reinvested at the firm's cost of capital, and the initial outlays are financed at the firm's financing cost. By contrast, the traditional internal rate of return (IRR) assumes the cash flows from a project are reinvested at the IRR.

The MIRR more accurately reflects the cost and profitability of a project.

➤ **Material Variance**

Material variance has two definitions, one relating to direct materials and the other to the size of a variance. They are:

- *Related to materials.* This is the difference between the actual cost incurred for direct materials and the expected (or standard) cost of those materials. It is useful for determining the ability of a business to incur materials costs close to the levels at which it had planned to incur them. However, the expected (or standard) cost of materials can be a negotiated figure or only based on a certain purchase volume, which renders this variance less usable. The variance can be further subdivided into the purchase price variance and the material yield variance. They are:
 - *Purchase price variance.* This is concerned solely with the price at which direct materials were acquired. The calculation is: $(\text{Actual price} - \text{Standard price}) \times \text{Actual quantity}$
 - *Material yield variance.* This is concerned solely with the number of units of the materials used in the production process. The calculation is: $(\text{Actual unit usage} - \text{Standard unit usage}) \times \text{Standard cost per unit}$
- *Related to size of variance.* A variance is considered to be material if it exceeds a certain percentage or dollar amount. This approach to the material variance is commonly used by auditors, who (for example) may ask to see explanations of all variances exhibiting a change of at least \$25,000 or 15% from the preceding year. A variation on the concept is to consider a transaction material if its presence or absence would alter the decisions of a user of a company's financial statements.

➤ **Trade discount**

A trade discount is the amount by which a manufacturer reduces the retail price of a product when it sells to a reseller, rather than to the end customer. The reseller then charges the full retail price to its customers in order to earn a profit on the difference between the amount by which the manufacturer sold the product to it and the price at which it then sells the product to the final customer. The reseller does not necessarily resell at the suggested retail price; selling at a discount is a common practice, if the reseller wishes to gain market share or clear out excess inventory. A trade discount is also known as a *functional discount*.

➤ **What is accounting treatment of trade discount?**

There is no accounting treatment of trade discount. However, it is deducted from listed price of an item.

➤ **Accounting Errors**

Accounting errors are those mistakes which occurs in the book keeping or accounting, relating to a routine activity or relating to the principle of accounting. The Accounting errors happens in entering the transactions in journal or subsidiary books or at the time of posting of entries in to the ledger. The accounting errors may happen because of the omission, commission, principle or as a compensating of errors.

Classification of accounting errors

Accounting errors are classified in to four types on the basis of nature of Errors. They are (1) Errors of Omission, (2) Errors of Commission, (3) Errors of Principles and (4) Compensating Errors.

(1) Errors of Omission

The Errors of Omission will occur when a transaction is not recorded in the books of accounts or omitted by mistake. The Errors of Omission may happen as partial or complete. The partial errors may happen in relation to any subsidiary books. This is the result of when a transaction is entered in the subsidiary book but not posted to the ledger. For example, cash paid to the suppliers has been entered in the payment side of the cash book but it will not be entered in the debit side of the suppliers account. The complete omission may happen the transaction is completely omitted from the books of accounts. For example, an accountant fails to enter a specific invoice from the sales day book.

(2) Errors of Commission

When a transaction is entered in the books of accounts in wrongly, this may be entered as partially or incorrectly. This kind of errors are known as Errors of Commission. The Errors of Commission may happens because of ignorance or negligence of the accountant. This may be of different types, the main reasons are Errors relating to subsidiary books and Errors relating to ledger.

(3) Errors of Principles

This kind of errors are occurs when the entries are made against the principle of accounting. These Errors are made because of the following reasons:-

1. Errors happens due to the inability to make a distinction between the revenue and capital items.
2. Errors happens due to the inability to make a difference between the business expenses and personal expenses.

3. Errors happens because of the inability to make a distinction between the productive expense and nonproductive expenses.

(4) Compensating Errors

Compensating Errors are those errors which compensates themselves in the net results of the business. This means, if there are over debit in one account which will be compensated by the over credit in some account in the same extent of the business. Like that, if there is a wrong debit in one account which will be neutralized by some wrong credit in the same extent of the business. The accounting errors will hardly affect the accuracy of trial balance of the business because the trial balance is the final proof of the books of accounts. There are some of the methods to rectify the accounting errors happened in the books of accounts. The important two methods for rectifying the accounting errors are as follow.

À striking of the wrong Entry.

À making appropriate entries to correct the errors.

Procedure for rectifying Accounting errors.

There are mainly three steps to rectify the accounting errors in the books of accounts.

- a. Ascertain the error occurred
- b. Identify the correct record of transaction which has to be done.
- c. Decide the rectification entry.

These all are the different kinds of accounting errors and the methods to rectify those errors.

➤ **CAPM**

The capital asset pricing model (CAPM) is a model that describes the relationship between systematic risk and expected return for assets, particularly stocks. CAPM is widely used throughout finance for the pricing of risky securities, generating expected returns for assets given the risk of those assets and calculating costs of capital.

➤ **Is there any outflow of cash while recording prepaid expenses?**

Prepaid expenses are assets on the balance sheet that do not reduce net income or shareholder's equity. However, prepaid expenses do reduce cash. Adjusting for an increase in prepaid expense is similar to adjusting for an increase in accounts receivable: they both decrease cash flow.

➤ **Current Assets – Current Liabilities=?**

Working Capital

➤ **Price variance**

Price variance is the actual unit cost of a purchased item, minus its standard cost, multiplied by the quantity of actual units purchased. The price variance formula is:

$$(\text{Actual cost incurred} - \text{standard cost}) \times \text{Actual quantity of units purchased} = \text{Price variance}$$

➤ **Revenue receipts record in which statement?**

Income Statement

➤ **Is increase in asset debit or credit?**

Debit

➤ **Why bank record cash on credit side?**

Because cash of customer is bank's liability. So bank record it on credit side.

➤ **Can we say direct labor is direct expense?**

The cost of labor is broken into direct and indirect (overhead) costs. Direct costs include wages for the employees that produce a product, including workers on an assembly line, while indirect costs are associated with support labor, such as employees who maintain factory equipment.

➤ **Vertical Analysis**

Vertical analysis is a method of financial statement analysis in which each entry for each of the three major categories of accounts, or assets, liabilities and equities, in a balance sheet is represented as a proportion of the total account. Vertical analysis is also used across other financial statements as a percentage measure.

➤ **Horizontal Analysis**

A horizontal analysis, or trend analysis, is a procedure in fundamental analysis in which an analyst compares ratios or line items in a company's financial statements over a certain period of time. The analyst uses his discretion when choosing a particular timeline; however, the decision is often based on the investing time horizon under consideration.

➤ **Closing stock**

Closing stock is the amount of inventory that a business still has on hand at the end of a reporting period. This includes raw materials, work-in-process, and finished goods inventory. The amount of closing stock can be ascertained with a physical count of the inventory.

➤ **What are services, its examples?**

Intangible products such as accounting, banking, cleaning, consultancy, education, insurance, expertise, medical treatment, or transportation.

Sometimes services are difficult to identify because they are closely associated with a good; such as the combination of a diagnosis with the administration of a medicine. No transfer of possession or ownership takes place when services are sold, and they (1) cannot be stored or transported, (2) are instantly perishable, and (3) come into existence at the time they are bought and consumed. See also service.

➤ **Cost component**

Companies that manufacture a product face an expanded set of accounting issues. In addition to the usual accounting matters associated with selling and administrative activities, a manufacturer must deal with accounting concerns related to acquiring and processing raw materials into a finished product. Accounting for this manufacturing process entails consideration of three key cost components that are necessary to produce finished goods.

Direct Materials

The cost of all materials that are an integral part of a finished product and that have a physical presence that is readily traced to that finished product.

Examples for a computer maker include the plastic housing of a computer, the face of the monitor screen, the circuit boards within the machine, and so forth. Minor materials such as solder, tiny strands of wire, and the like, while important to the production process, are not cost effective to trace to individual finished units. These costs are termed “indirect materials.” Indirect materials are included with other components of manufacturing overhead, as discussed below.

Direct Labor

Consists of gross wages paid to those who physically and directly work on the goods being produced. For example, wages paid to a welder in a bicycle factory who is actually fabricating the frames of bicycles would be included in direct labor. On the other hand, the wages paid to a welder who is building an assembly line that will be used to produce a new line of bicycles is not direct labor. In general, indirect labor pertains to wages of other factory employees (e.g., maintenance personnel, supervisors, guards, etc.) who do not work directly on a product. Indirect labor is considered to be manufacturing overhead.

Manufacturing Overhead

All costs of manufacturing other than direct materials and direct labor.

Examples include indirect materials, indirect labor, and factory related depreciation, repair, insurance, maintenance, utilities, property taxes, and so forth. Factory overhead is also known as indirect manufacturing cost, burden, or other synonymous terms. Factory overhead is difficult to trace to specific finished units, but its cost is important and must be allocated to those units. Normally, this allocation is applied to ongoing production based on estimated allocation rates, with subsequent adjustment processes for over- or under-applied overhead. This is quite important to product costing.

➤ **Component of FOH**

1. Indirect Material

Factory Supplies
Lubricants and Fuels

2. Indirect Labor

Supervision (Factory Supervisor Salary)
Superintendence (Salary)
Inspection Team Salary
Salaries of Factory Clerks
Defective work Salary
Experimental Work

3. Other Indirect Costs

Rent
Insurance Fire
Property tax on Factory Building
Depreciation of Plant and Machinery
Maintenance and Repair (Factory Building, Factory Machinery)
Power, Heat and Light of Factory
Employer payroll
Factory Taxes
Miscellaneous Factory Overhead
Small tools

➤ **Research & development cost and its accounting treatment**

The accounting for research and development involves those activities that create or improve products or processes. The core accounting rule in this area is that expenditures be charged to expense as incurred. Examples of activities typically considered to fall within the research and development functional area include the following:

- Research to discover new knowledge
- Applying new research findings
- Formulating product and process designs
- Testing products and processes
- Modifying formulas, products, or processes
- Designing and testing prototypes
- Designing tools that involve new technology
- Designing and operating a pilot plant

Research and Development Accounting

The basic problem with research and development expenditures is that the future benefits associated with these expenditures are sufficiently uncertain that it is difficult to record the expenditures as an asset. Given these uncertainties, GAAP mandates that all research and development expenditures be charged to expense as incurred. The chief variance from this guidance is in a business combination, where the acquirer can recognize the fair value of research and development assets.

The basic rule of charging all research and development expenditures to expense is not entirely pervasive, since there are exceptions, as noted below:

- *Assets.* If materials or fixed assets have been acquired that have alternative future uses, record them as assets. The materials should be charged to expense as consumed, while depreciation should be used to gradually reduce the carrying amount of the fixed assets. Conversely, if there are no alternative future uses, charge these costs to expense as incurred.
- *Computer software.* If computer software is acquired for use in a research and development project, charge the cost to expense as incurred. However, if there are future alternative uses for the software, capitalize its cost and depreciate the software over its useful life.
- *Contracted services.* If the company is billed by third parties for research work conducted on behalf of the company, charge these invoices to expense.
- *Indirect costs.* A reasonable amount of overhead expenses should be allocated to research and development activities.
- *Purchased intangibles.* If intangible assets are acquired from third parties and these assets have alternative uses, they are to be accounted for as intangible assets. However, if the intangibles are purchased for a specific research project and there are no alternative future uses, charge those to expense as incurred.
- *Software development.* If software is developed for use in research and development activities, charge the associated costs to expense as incurred, without exception.
- *Wages.* Charge the costs of salaries, wages, and related costs to expense as incurred.

There may also be research and development arrangements where a third party (a sponsor) provides funding for the research and development activities of a business. The arrangements may be designed to shift licensing rights, intellectual property ownership, an equity stake, or a share in the profits to the sponsors. The business conducting the research and development activities may be paid a fixed fee or some form of cost reimbursement arrangement by the sponsors.

These arrangements are frequently constructed as limited partnerships, where a related party fulfills the role of general partner. The general partner may be authorized to obtain additional funding by selling limited-partner interests, or extending loans or advances to the partnership that may be repaid from future royalties.

When an entity is a party to a research and development arrangement, several accounting issues must be resolved, which are:

- *Loans or advances issued.* If the business lends or advances funds to third parties, and repayment is based entirely on whether there are economic benefits associated with the research and development work, charge these amounts to expense.
- *Nonrefundable advances.* Defer the recognition of any nonrefundable advance payments that will be used for research and development activities, and recognize them as expenses when the related goods are delivered or services performed. If at any point it is not expected that the goods will be delivered or services performed, charge the remaining deferred amount to expense.

- *Obligation to perform services.* If repayment of the funds provided by the funding parties is solely dependent upon the results of the related research and development activities, account for the repayment obligation as a contract to perform work for others.
- *Repayment obligation.* If there is an obligation to repay the funding parties or the business has indicated an intent to do so, no matter what the outcome of the research and development may be, recognize a liability for the amount of the repayment, and charge research and development costs to expense as incurred. This accounting is also required if there is a significant related party relationship between the business and the funding entities. This scenario also applies if the funding parties can require the business to purchase their interest in the partnership, or if the funding parties automatically receive securities from the business upon termination of the arrangement.
- *Warrants issuance.* If the business issues warrants as part of a funding arrangement, allocate a portion of paid-in funds to paid-in capital. The amount allocated to warrants should be their fair value as of the date of the arrangement.
- **Excess of net assets over net liabilities?**
Net worth
- **If bank account shows negative balance what does it mean?**
Overdraft (Payable by customer to bank)
- **Total depreciation could not exceed ----- of asset?**
Cost
- **Capital Employed**
Capital employed, also known as funds employed, is the total amount of capital used for the acquisition of profits. It is the value of all the assets employed in a business and can be calculated by adding fixed assets to working capital or subtracting current liabilities from total assets. By employing capital, you make an investment.
- **Return on Capital Employed (ROCE)**
Return on capital employed (ROCE) is a financial ratio that measures a company's profitability and the efficiency with which its capital is employed. ROCE is calculated as:
$$\text{ROCE} = \frac{\text{Earnings before Interest and Tax (EBIT)}}{\text{Capital Employed}}$$

“Capital Employed” as shown in the denominator is the sum of shareholders' equity and debt liabilities; it can be simplified as (Total Assets – Current Liabilities). Instead of using capital employed at an arbitrary point in time, analysts and investors often calculate ROCE based on “Average Capital Employed,” which takes the average of opening and closing capital employed for the time period. A higher ROCE indicates more efficient use of capital. ROCE should be higher than the company's capital cost; otherwise it indicates that the company is not employing its capital effectively and is not generating shareholder value.
- **Investment appraisal techniques. Which one is best?**
The capital investment appraisal techniques used to measure capital investment appraisal of a business project include:
 - Net present value
 - Accounting rate of return
 - Internal rate of return
 - Modified internal rate of return
 - Adjusted present value
 - Profitability index
 - Equivalent annuity
 - Payback period
 - Discounted payback period
 - Real option analysisNPV is best.
- **Cost center**
A cost center is a business unit that is only responsible for the costs that it incurs. The manager of a cost center is not responsible for revenue generation or asset usage. The performance of a cost center is usually evaluated through the comparison of budgeted to actual costs. The costs incurred by a cost center may be aggregated into a cost pool and allocated to other business units, if the cost center performs services for the other business units.
Examples of cost centers are as follows:
 - Accounting department
 - Human resources department

- IT department
- Maintenance department
- Research & development

A cost center can be defined at a smaller level than a department. It could involve a particular job position, machine, or assembly line. However, this more detailed view of cost centers requires more detailed information tracking, and so is not commonly used.

The management focus in a cost center is usually on keeping expenditures down to a minimum level, possibly by using outsourcing, automation, or capping pay levels. The main exception is when a cost center indirectly contributes to profitability (such as R&D), in which case a certain minimum expenditure level will be needed to support sales.

➤ **Voucher**

A *voucher* is an internal document used in a company's accounts payable department in order to collect and organize the necessary documentation and approvals before paying a vendor invoice. The voucher acts as a cover page to which the following will be attached: vendor invoice, company's purchase order, company's receiving report, and other information needed to process the vendor invoice for payment.

➤ **Invoice**

An invoice from a vendor is the bill that is received by the purchaser of goods or services from an outside supplier. The vendor invoice lists the quantities of items, brief descriptions, prices, total amount due, credit terms, where to remit payment, etc.

➤ **Window dressing**

Window dressing is actions taken to improve the appearance of a company's financial statements.

Window dressing is particularly common when a business has a large number of shareholders, so that management can give the appearance of a well-run company to investors who probably do not have much day-to-day contact with the business. It may also be used when a company wants to impress a lender in order to qualify for a loan. If a business is closely held, the owners are usually better informed about company results, so there is no reason for anyone to apply window dressing to the financial statements.

➤ **JIT**

Just-in-time (JIT) is an inventory strategy companies employ to increase efficiency and decrease waste by receiving goods only as they are needed in the production process, thereby reducing inventory costs. This method requires producers to forecast demand accurately.

Difference between engagement and management letter? (Engagement letter is issued by auditor and is returned back by the client after endorsing his signatures. While management letter is issued by auditor and in this auditor points out the weakness in internal control related to financial reporting.

➤ **CAPAM**

The capital asset pricing model (CAPM) is a model that describes the relationship between systematic risk and expected return for assets, particularly stocks. CAPM is widely used throughout finance for the pricing of risky securities, generating expected returns for assets given the risk of those assets and calculating costs of capital.

The capital asset pricing model (CAPM) is used to calculate the required rate of return for any risky asset. Your required rate of return is the increase in value you should expect to see based on the inherent risk level of the asset.

How it works (Example):

As an analyst, you could use CAPM to decide what price you should pay for a particular stock. If Stock A is riskier than Stock B, the price of Stock A should be lower to compensate investors for taking on the increased risk.

The CAPM formula

is: $r_a = r_{rf} + \beta_a (r_m - r_{rf})$

Where:

r_{rf} = the rate of return for a risk-free security

r_m = the broad market's expected rate of return

β_a = beta of the asset

➤ **Capital Expenditure**

Capital expenditure, or CapEx, are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment. It is often used to undertake new projects or investments by the firm. This type of outlay is also made by companies to maintain or increase the scope of their

operations. These expenditures can include everything from repairing a roof to building, to purchasing a piece of equipment, or building a brand new factory.

➤ **Revenue Expenditure**

An amount that is expensed immediately. For example, routine repair costs on equipment are revenue expenditures because they are charged directly to an income statement account such as Repairs and Maintenance Expense.

➤ **Conversion Cost**

Conversion costs are the combination of direct labor costs plus manufacturing overhead costs.

You can think of conversion costs as the manufacturing or production costs necessary to convert raw materials into products. Expressed another way, conversion costs are a manufacturer's product or production costs other than the costs of raw materials.

The term *conversion costs* often appears in the calculation of the cost of an equivalent unit in a process costing system.

➤ **Prime Cost**

Prime cost is the combination of a manufactured product's costs of direct materials and direct labor. In other words, prime cost refers to the *direct production costs*. Indirect manufacturing costs are *not* part of prime cost.

➤ **Modified Cash Base Accounting**

An accounting method that combines elements of the two major accounting methods, the cash method and the accrual method. The cash method recognizes income when it is received and expenses when they are paid for, whereas the accrual method recognizes income when it is earned (for example, when the terms of a contract are fulfilled) and expenses when they are incurred. The modified cash basis method uses accruals for long-term balance sheet elements and the cash basis for short-term ones.

➤ **Imprest System**

The imprest system is an accounting system for paying out and subsequently replenishing petty cash. Petty cash is a small reserve of cash kept on-site at a business location for incidental cash needs. The imprest system is designed to provide a rudimentary manual method for tracking petty cash balances and how cash is being used. The essential features of an imprest system are:

- A fixed amount of cash is allocated to a petty cash fund, which is stated in a separate account in the general ledger.
- All cash distributions from the petty cash fund are documented with receipts.
- Petty cash disbursement receipts are used as the basis for periodic replenishments of the petty cash fund.
- Variances between expected and actual fund balances are regularly reviewed and investigated.

In essence, expenses are recognized when new cash replenishments are made to the petty cash fund from the company checking account. When cash is paid from the checking account, the entry is a debit to the various expenses for which receipts are being supplied by the petty cash custodian, and a credit to the cash account.

Unless the amount of cash assigned to the petty cash fund is deliberately altered, there is no reason why there should ever be another entry into the account used to document the petty cash balance, since all petty cash replenishments are coming from the company checking account.

The main feature of this system is the need to document all expenditures. Doing so is an excellent way to maintain a high level of control over cash disbursements.

The imprest system is declining in popularity, since many businesses prefer to use company credit cards for incidental purchases, or have employees pay cash and then apply for reimbursement through the corporate expense reimbursement system. Also, the imprest system can cause cash leakage from a business, either through theft of the cash or because the petty cash custodian does not do a proper job of recording disbursements.

Auditing

➤ **Audit**

An audit is an objective examination and evaluation of the financial statements of an organization to make sure that the records are a fair and accurate representation of the transactions they claim to represent. It can be done internally by employees of the organization, or externally by an outside firm.

➤ **Characteristic of audit?**

Audits have multiple standards, or characteristics, to which they must adhere. Typically, these standards are described in terms of actions the auditor must take while conducting the audit. By following these basic standards, auditors can ensure that the audits they perform are reliable and meet the needs of the client.

Training

One of the most basic standards for an audit is that the auditor has to be trained to conduct the audit properly. He must be familiar with standard accounting principles as well as with business management and administration. In most cases, a degree in business or accounting, along with certification by organizations such as the American Institute of Certified Public Accountants, usually provides some verification of the auditor's capabilities. The amount of experience the auditor has also indicates whether he is qualified.

Independence

Auditors must conduct audits independently, which means they have to remain objective throughout the audit process. If the auditor fails to remain objective, the results of the audit may be skewed toward the auditor's preferences or beliefs and therefore will not represent what really is happening or what is best for the company. The auditor should not appear to be associated with the company's interests outside of the audit.

Due Professional Care

Another characteristic of a proper audit is that the auditor uses due professional care. He uses all of his business and accounting knowledge to gather the information necessary to determine what is happening within the company to render a logical, unbiased opinion to managers. He also is careful not to reveal confidential information to unauthorized parties. This characteristic describes the auditor's fiduciary duty to the company using his services.

Planning, Supervision and Sufficiency

Planning is the first phase of all audits. It is a major characteristic of audits because failure to plan results in the auditor being less efficient. Part of proper planning involves hiring any audit assistants necessary and supervising them well. As the auditor and his assistant's progress through their audit plan, they must gather information sufficient to meet the audit's objectives and support the opinions rendered.

Statements

If an audit is performed well, the auditor explains in his report whether the information received adheres to current accounting standards. He also details any circumstances that led the company to deviate from those standards if deviations are present. The auditor tells whether the information he has received is accurate and states a formal opinion about the results of the audit or shows why he couldn't reach a conclusion.

➤ **Types of Audit**

Audit is an appraisal activity undertaken by an independent practitioner (e.g. an external auditor) to provide assurance to a principal (e.g. shareholders) over a subject matter (e.g. financial statements) which is the primary responsibility of another person (e.g. directors) against a given criteria or framework (e.g. IFRS and GAAP). Main types of audit engagements and services include:

- External Audit
- Internal Audit
- Forensic Audit
- Public Sector Audit
- Tax Audit

- Information System Audit
- Environmental & Social Audit
- Compliance Audit
- Value for Money Audit

External

External audit, also known as financial audit and statutory audit, involves the examination of the truth and fairness of the financial statements of an entity by an external auditor who is independent of the organization in accordance with a reporting framework such as the IFRS. Company law in most jurisdictions requires external audit on annual basis for companies above a certain size.

The need for an external audit primarily stems from the separation of ownership and control in large companies in which shareholders nominate directors to run the affairs of the company on their behalf. As the directors report on the financial performance and position of the company, shareholders need assurance over the accuracy of the financial statements before placing any reliance on them. External audit provides reasonable assurance to the owners of the company that the financial statements, as reported by the directors, are free from material misstatements.

External auditors are required to comply with professional auditing standards such as the International Standards on Auditing and ethical guidelines such as those issued by IFAC in order to maintain a level of quality and trust of all stakeholders in the auditing exercise.

Internal

Internal audit, also referred as operational audit, is a voluntary appraisal activity undertaken by an organization to provide assurance over the effectiveness of internal controls, risk management and governance to facilitate the achievement of organizational objectives. Internal audit is performed by employees of the organization who report to the audit committee of the board of directors as opposed to external audit which is carried out by professionals independent of the organization and who report to the shareholders via audit report.

Unlike external audit, whose scope is primarily restricted to matters that concern the financial statements, the scope of work of an internal audit is very broad and can encompass any matters which can affect the achievement of organizational objectives. Internal audit is typically centered around certain key activities which include:

Monitoring the effectiveness of internal controls and proposing improvements
Investigating instances of fraud and theft

Monitoring compliance with laws and regulations

Reviewing and verifying where necessary the financial and operating information
Evaluating risk management policies and procedures of the company

Examining the effectiveness, efficiency and economy of operations and processes

Forensic

Forensic Audit involves the use of auditing and investigative skills to situations that may involve legal implications. Forensic audits may be required in the following instances:

Fraud investigations involving misappropriation of funds, money laundering, tax evasion and insider trading

Quantification of loss in case of insurance claims

Determination of the profit share of business partners in case of a dispute

Determination of claims of professional negligence relating to the accountancy profession
Findings of a forensic audit could be used in the court of law as expert opinion on financial matters.

Public Sector

State owned companies and institutions are required by law in several jurisdictions to have their affairs examined by a public sector auditor. In many countries, public sector audits are conducted under the supervision of the auditor general which is an institute responsible for strengthening public sector accountability and governance and promoting transparency.

Public sector audit involves the scrutiny of the financial affairs of the state owned enterprises to assess whether they have been operated in way which is in the best interest of the public and whether standard procedures have been followed to comply with the requirements in place to promote transparency and good governance (e.g. public sector procurement rules). Public sector audit therefore goes a step further

than the financial audit of private organizations which primarily focuses on the reliability of financial statements

Audits of public sector companies are becoming increasingly concerned with the efficiency, effectiveness and economy of resources used in state organizations which has given way for the development of value for money audits.

Tax

Tax audits are conducted to assess the accuracy of the tax returns filed by a company and are therefore used to determine the amount of any over or under assessment of tax liability towards the tax authorities. In some jurisdictions, companies above a certain size are required to have tax audits after regular intervals while in other jurisdictions random companies are selected for tax audits through the operation of a balloting system.

Information System

Information system audit involves the assessment of the controls relevant to the IT infrastructure within an organization. Information system audits may be performed as part of the internal control assessment during internal or external audit.

Information system audit generally comprises of the evaluation of the following aspects of information system:

- Design and internal controls of the system
- Information security and privacy
- Operational effectiveness and efficiency
- Information processing and data integrity
- System development standards

Environmental & Social

Environmental & Social Audits involve the assessment of environmental and social footprints that an organization leaves as a consequence of its economic activities. The need for environmental auditing is increasing due to higher number of companies providing environment and sustainability reports in their annual report describing the impact of their business activities on the environment and society and the initiatives taken by them to reduce any adverse consequences.

Environmental auditing has provided a means for providing assurance on the accuracy of the statements and claims made in such reports. If for example a company discloses the level of CO₂ emissions during a period in its sustainability report, an environment auditor would verify the assertion by gathering relevant audit evidence.

Compliance

In many countries, companies are required to conduct specific audit engagements other than the statutory audit to comply with the requirements of particular laws and regulations. Examples of such audits include:

Verification of reserves available for distribution to shareholders before the declaration of interim dividend

Audit of the statement of assets and liabilities submitted by a company at the time of liquidation

Performance of cost audit of manufacturing companies to verify the cost of production in order for a regulator to determine the maximum price to be allowed after allowing a reasonable profit margin to companies operating in a sensitive sector (e.g. pharmaceuticals industry)

Value for Money

Value for money audits involves the assessment of the efficiency, effectiveness and economy of an organization's use of resources.

Value for money audits are increasingly relevant to sectors which do not have profit as their main objective such as the public sector and charities. They are usually performed as part of internal audit or public sector audit.

➤ **Audit Risk**

Audit risk is the risk that the financial statements are materially incorrect, even though the audit opinion states that the financial reports are free of any material misstatements. The two components of audit risk are the risk of material misstatement and detection risk. Because creditors, investors and other stakeholders rely on the financial statements, audit risk may carry legal liability for a CA firm performing audit work.

➤ **Materiality**

Materiality is the threshold above which missing or incorrect information in financial statements is considered to have an impact on the decision making of users. Materiality is sometimes construed in terms of net impact on reported profits, or the percentage or dollar change in a specific line item in the financial statements. Examples of materiality are as follows:

A company reports a profit of exactly \$10,000, which is the point at which earnings per share exactly meet analyst expectations. Any profit below this point would have triggered a sell off of company shares, and so would be considered material.

A company reports a current ratio of exactly 2:1, which is the amount needed to meet its loan covenants. Any current asset or current liability amounts resulting in a ratio of less than 2:1 would be considered material, since the loan could then be called by the lender.

➤ **Why audit is necessary?**

Without a system of internal controls or an audit system, a company would not be able to create reliable financial reports for internal or external purposes. Accordingly, an audit system is crucial in preventing debilitating misstatements in a company's records and reports.

➤ **Scope of Audit**

The term "Scope of Audit" means the audit procedure which is considered necessary for the achievement of desired objectives. The auditor should keep in view the following points: 1.

Legal Conditions:-

While determining the scope of audit and auditor should follow the rules and regulations applicable on the audit work.

2. Validity of Data:-

The auditor should use various methods to test the validity of data. He should confirm that data provided in the financial statement is reliable.

3. Cover All the Aspects:-

The auditor should cover all the functions of business, know all its working any aspect related to financial statement may not be ignored. A business is small or large auditor should cover all the areas. 4. **Comparison:-**

The auditor can compare the accounts record with the financial statement to know the true picture. He determines whether the relevant information is properly communicated or not.

5. Apply His Skill:-

While preparing the report, an auditor should apply his professional skill and experience to prove that figures and facts.

6. Sufficient Record:-

The auditor checks that record and relevant data is sufficient. He also uses other tests and verification procedure.

7. Judgment:-

The auditor also considers the judgment of the management made in preparing the financial statements. The auditor must have the quality of judgment when he fails to find the data in the books of account. 8.

Internal Check:-

It is not possible for the auditor to check each and every voucher and transaction, so he should try to rely on internal check system. He is also bound to make guess work on the basis of available data.

9. Persuasive Evidence:-

The auditor his opinion as true fair instead of cent percent correct because the available evidence is persuasive. The personal judgment also affect the value of any items.

10. Misstatement Problem:-

Due to the limitations of audit sometimes some material misstatements remain undiscovered. So statement do not show the exact view of operations.

11. Clear The Doubts:-

If the auditor smells any fraud, he should check cent percent items and clear his doubts. He should extend the procedure to confirm his doubts.

12. Opinion of Auditor:-

If auditor is satisfied about financial information of business then he can express the unqualified opinion otherwise he will express qualified opinion.

➤ **Internal Control**

Systematic measures (such as reviews, checks and balances, methods and procedures) instituted by an organization to (1) conduct its business in an orderly and efficient manner, (2) safeguard its assets and resources, (3) deter and detect errors, fraud, and theft, (4) ensure accuracy and completeness of its accounting data, (5) produce reliable and timely financial and management information, and (6) ensure adherence to its policies and plans.

➤ **Types of Internal Control**

Preventive Controls are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure departmental objectives are being met. Examples of preventive controls are:

- Segregation of Duties: Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.
- Approvals, Authorizations, and Verifications: Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.
- Security of Assets (Preventive and Detective): Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.

Detective Controls are designed to find errors or irregularities after they have occurred. Examples of detective controls are:

- Reviews of Performance: Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
- Reconciliations: An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.
- Physical Inventories
- Audits

➤ **Audit Opinion**

In financial reporting, an **auditor's opinion** is the outcome of an auditor's review of an organization's financial statements.

The auditor's opinion does not judge the financial position of the reporting entity. Nor does it otherwise interpret financial data. Instead, the opinion simply answers two questions:

Firstly, do the statements conform to Generally Accepted Accounting Principles (GAAP)? And, secondly, do they fairly represent the entity's financial accounts?

Four names for the opinion

Note that formal audit results may be called Auditor's Opinion, Report, or Statement. Or, they may also appear as Accountant's Opinion, Report, or Statements. These terms all mean almost the same thing.

The **Accountant's Opinion** or **Auditor's Opinion** focuses on the actual *opinion*, one of four possible outcomes described below.

The terms **Statement** or **Report** imply that the text includes the opinion, but also:

- The responsibilities of auditors.
 - Responsibilities of directors and corporate officers.
 - The scope of coverage.
- Four possible audit outcomes

Sections below further define and explain financial reporting audits. Four kinds of outcomes are covered:

- Unqualified opinion
- Qualified opinion
- Adverse opinion
- Disclaimer of opinion

➤ **Unqualified Opinion**

Firstly, the **unqualified opinion** is the best possible audit outcome. And, it is also by far the most frequently reported in just a few areas. For these areas, the auditor cannot assert conformance. The qualified opinion may result because:

The report misstates or misclassifies accounting entries. For example, an expense that should appear above the gross profit line appears wrongly below it. This leads to misleading gross profit figures.

There are limits opinion. By contrast, the other three outcomes are rarely issued.

The term "unqualified" means that the auditor has decided that:

- Financial statements conform to Generally Accepted Accounting Principles (GAAP).
- And, statements represent the entity's financial accounts fairly.

➤ **Qualified Opinion**

Secondly, a **qualified opinion** means the auditor finds that reports conform to GAAP, except in just a few areas. For these areas, the auditor cannot assert conformance.

The qualified opinion may result because:

- The report misstates or misclassifies accounting entries. For example, an expense that should appear above the gross profit line appears wrongly *below* it. This leads to misleading gross profit figures.
- There are limits on audit scope. This can mean, for instance, that auditors are denied access to certain financial data.
- The auditor doubts the veracity of certain financial data.
- The auditor is not fully confident that reports:
 - Comply with GAAP.
 - Represent the entity's accounts fairly.

In conclusion, auditors report the audit outcome as "qualified" when they are not comfortable calling it either "unqualified" or "adverse." With qualified opinions, auditors state specific reasons for the opinion.

➤ **Adverse Opinion**

Thirdly, an **adverse opinion** means the auditor finds the following.

- Statements do *not* fairly represent the entity's accounts.
- And, the audited statements do not comply with GAAP.

Before publishing an adverse opinion, auditors advise the firm's accountants and officers of such problems. And, auditors then work with them to correct problems, insofar as they can. They do this hoping to describe the outcome as "unqualified" or "qualified" opinion, instead of "adverse," if possible. When auditors do report an adverse opinion, they give specific reasons for the opinion. As a result, auditors may point out specific accounting errors or departures from GAAP.

In any case, an adverse opinion has serious consequences for the reporting entity. At a minimum, the opinion ensures that reports will be rejected by investors, regulators, lenders, and governments.

In addition, if the audit reveals illegalities, corporate officers may be held personally accountable.

➤ **Disclaimer of Opinion**

Fourthly, auditors may issue a **disclaimer of opinion**. Note especially that this is not an *opinion*.

Instead, it simply says that auditors choose not to issue an opinion.

Auditors may issue a disclaimer of opinion when:

- They believe they cannot audit *impartially*. With the disclaimer, therefore, auditors *recuse* themselves.
- The auditor's scope is limited. This occurs, for instance, when auditors cannot access certain financial data.
- Auditors have other doubts about the reports. For example:
 - Reports may seem to violate accounting principles such as the *matching concept* or the *conservatism principle*.
 - Auditors may question the classification of certain revenues and expenses.
 - Some capitalized items probably should not have been capitalized.
 - They may question the way the entity applies rules such as the Lower of Cost or Market rule, or LIFO and FIFO rules for inventory.

Auditors issue opinions only when they are confident the opinion is *supportable*. Otherwise, they issue a disclaimer of opinion.

➤ **Characteristics of audit report**

Unbiased

Disclose all facts and the truth

Simplicity

Clarity

Brevity

Firmness

Objectivity

Consistency

Accepted principle

Disclosure principle

It complies with ISA Standards

Achieves its Purpose

Shows Severity of problems

How to correct problems

➤ **Vouching and its objectives**

Voucher is known as the evident for the support of a transaction in the books of account. It may be bill, receipts, requisition form, agreement, decision, bank paying slip etc.

The act of examining documentary evidence in order to ascertain the accuracy of entries in the account books is called "Vouching". Vouching is a technical term which refers to the inspection by the auditor of documentary evidence supporting and substantiating a transaction. Simply stated, vouching means a careful examination of all original evidence i.e invoices, statements, receipts, correspondence, minutes and contracts etc. with a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible, that no entries have been omitted in the books of accounts. Therefore, vouching is the act of testing the truth of entries appearing in the primary books of accounts. It is initial for auditing.

Objectives of Vouching

Main objective of vouching is to find out the regularity or irregularity of transactions, frauds and errors. Regularity means maintaining record and performing the work compliance with the rules, regulation and law. But irregularity means doing the work crossing to the line of rules, regulation and laws. Some of the major objectives of vouching are given below:

1. To Detect Errors and Frauds
2. To Know the Truth of Account
3. To Find the Unrecorded Transactions
4. To Know That All the Transactions Are Authorized
5. To Know That Only the Business Transactions Are Recorded

➤ **Verification and its objectives**

Verification means 'Proving the truth' or 'Confirmation'. Verification is an auditing process in which auditor satisfy himself with the actual existence of assets and liabilities appearing in the Statement of Financial position. Verification is usually conducted through examination of existence, ownership, title, possession, proper valuation and presence of any charge of lien over assets.

Thus, verification includes verifying:

1. The existence of the assets and liabilities.
2. Legal ownership and possession of the assets
3. Correct valuation, and
4. Ascertaining that the asset is free from any charge

Objectives of Verification are:

1. To show correct valuation of assets and liabilities.
2. To know whether the balance sheet exhibits a true and fair view of the state of affairs of the business
3. To find out the ownership and title of the assets
4. To find out whether assets were in existence
5. To detect frauds and errors, if any
6. To find out whether there is an adequate internal control regarding acquisition, utilization and disposal of assets.
7. To verify the arithmetic accuracy of the accounts
8. To ensure that the assets have been recorded properly

➤ **Qualities of an Auditor**

Professional Qualities | Personal Qualification of an Auditor

The professional qualities required for auditors are many and are of varied in nature. They are required for the successful performance of audit work. They are as follows:

1. The auditor must have a complete and thorough knowledge of the principles, theory and practice of accountancy. The auditor must be familiar with the different system of accounting and their aspects. He must be well versed with the all branches of accounting. He should be aware of the latest developments in the field of accounting.

2. He should have a thorough knowledge in various legislation regulating business such as Companies Act, the Indian Partnership Act, Banking and Insurance Act, Sale of Goods Act, Foreign Exchange Management Act, the Indian Contract Act, etc.
3. The auditor should have a thorough knowledge of the techniques of auditing. He should be fully aware of new changes and developments in the principles and practice of auditing.
4. The auditor must be familiar with the computer accounting and other automatic machine devices used in the office.
5. In addition to the knowledge of commercial laws, an auditor should have a thorough knowledge of the various provisions relating to income tax wealth tax, VAT, gift tax, etc.
6. The auditor should be familiar with the principles of economics and economic laws because a business has to work, within some specific economic laws and social environment and its influence is visible into business.
7. The auditor should have knowledge in statistics and mathematics, which will help him to deal with complicated problems.
8. He must study important judgments in audit cases, which will help him to define the duties, responsibilities, and liabilities of an auditor.
9. An auditor should have a good knowledge in business organization and financial administration, and industrial management.
10. The auditor should have knowledge on the technical details of business under audit.

Personal Qualities | General Qualities of an Auditor

Individual qualities are the essential monitors of a successful auditor. The personal qualities that are needed for an auditor are as follows:

1. **Honesty:** An auditor must be honest in his work if he has to carry out his duties successfully. He has to maintain a good moral standard.
2. **Tactful:** The auditor should be tactful in dealing with the client's staff.
3. **Ability to Work Hard:** The auditor must have a painstaking attitude and willingness to work hard.
4. **Impartial:** The auditor should not be influenced by any bias in discharging his duties. He should be impartial.
5. **Cautious and Vigilant:** An auditor must be vigilant in his work. He should always proceed with his eyes open and be alert.
6. **Methodical:** He must perform his duties methodically, and should be thorough, and complete in his work.
7. **Ability to Trace out Facts and Figures:** Auditor should possess a realistic attitude towards his work. He should be able to trace out facts and figures.
8. **Always Inquisitive:** The auditor should not be suspicious. He should always be inquisitive. He should not adopt an attitude of suspicion.
9. **Courage:** The auditor should be bold enough to discharge his duties. He should not certify which he doubts to be genuine.
10. **Ability to Maintain Secrets:** The auditor should have the ability to maintain secrets and should not disclose the secrets of his client to anybody.
11. **Ability to Communicate:** An auditor must have the ability to prepare audit report correctly and forcefully, precisely, concisely, and clearly.
12. **Common Sense:** An auditor should possess a good common sense. The auditor should have a full share of the most valuable commodity – common sense. But common sense is normally very much uncommon in man.

Over and above the statutory and professional qualification, the auditor has to observe certain code of conduct and professional ethics. Responsibility and attitude of professional auditor can gain public confidence and trust.

Further, in the digital age, majority of the business transactions are done on line. Accounts are maintained on computer. The Electronic Data Processing (EDP) systems are in operation for maintenance of accounts. No primary data are used for recording transaction. Thus the auditor has to acquire the knowledge of EDP System. He himself must be competent to face the challenges of new digital business world of E-Governance and E-Commerce.

➤ **Qualification of an Auditor**

Professional Qualification | Statutory Qualification of an Auditor

In the case of sole trading concern and partnership the law has not prescribed any qualification for an auditor. However in the case of auditors of joint stock companies, the auditor must be a Chartered Accountant within the meaning of Chartered Accountant Act, 1949.

He must pass Chartered Accountant (C.A) examination conducted by the Institute of Chartered Accountants of India (ICAI). To be entitled to practice, a chartered accountant should obtain a certificate of practice from the council of the ICAI on payment of a prescribed annual fee.

There are two categories of members of the ICAI such as – Associates, and Fellows.

A person is regarded as an **Associate Member of the Institute** when his name is entered in the Members Register maintained by the Institute. This entitles him to use the letters A.C.A. after his name.

An associate in continuous practice in India for at least five years under any other associate who has been a member of the Institute for five years and possesses such qualifications as prescribed by the Council of the Institute can be enrolled as a **Fellow of the Institute** and is entitled to use the letters F.C.A. after his name.

➤ **Pre audit and Post audit**

Pre-audit is an examination of vouchers, contracts, etc., in order to substantiate a transaction or a series of transactions before they are paid for and recorded.

Post-audit is an audit of accounting records, conducted at some interval of time after a transaction or a series of transactions has already occurred.

➤ **Appointment of an Auditor**

The first auditor of a company would usually be appointed by the directors, or alternatively the shareholders may appoint the auditor at the first Annual General Meeting (“AGM”).

Auditors are appointed at the AGM and hold office from the conclusion of the AGM to the conclusion of the next AGM. A retiring auditor shall be re-appointed without any resolution being passed unless:

- He is not qualified for re-appointment;
- A resolution has been passed at that meeting appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
- He has given the company notice in writing of his unwillingness to be re-appointed.

➤ **Performance Audit**

Performance audit refers to an independent examination of a program, function, operation or the management systems and procedures of a governmental or non-profit entity to assess whether the entity is achieving economy, efficiency and effectiveness in the employment of available resources.

➤ **Regulatory Audit**

Financial (regulatory) audits are designed to assess whether financial operations (management, collections and expenditure) of government have been legally executed and are these accounts a true and fair representation of the financial activities. Generally the annual accounts of government are reviewed. The review encompasses both financial and non-financial information, for example policy and financial management. The most common Regulatory Audit is the review of the government’s annual accounts.

➤ **Audit Procedures**

Audit procedures are used by auditors to determine the quality of the financial information being provided by their clients. The exact procedures used will vary by client, depending on the nature of the business and the audit assertions that the auditors want to prove. Here are several general classifications of audit procedures:

- *Classification testing.* Audit procedures are used to decide whether transactions were classified correctly in the accounting records. For example, purchase records for fixed assets can be reviewed to see if they were correctly classified within the right fixed asset account.
- *Completeness testing.* Audit procedures can test to see if any transactions are missing from the accounting records. For example, the client's bank statements could be perused to see if any payments to suppliers were not recorded in the books, or if cash receipts from customers were not recorded. As another example, inquiries can be made with management and third parties to see if the client has additional obligations that have not been recognized in the financial statements.
- *Cutoff testing.* Audit procedures are used to determine whether transactions have been recorded within the correct reporting period. For example, the shipping log can be reviewed to see if shipments to customers on the last day of the month were recorded within the correct period.
- *Occurrence testing.* Audit procedures can be constructed to determine whether the transactions that a client is claiming have actually occurred. For example, one procedure might require the client to show specific invoices that are listed on the sales ledger, along with supporting documentation such as a customer order and shipping documentation.
- *Existence testing.* Audit procedures are used to determine whether assets exist. For example, the auditors can observe an inventory being taken, to see if the inventory stated in the accounting records actually exists.

- *Rights and obligations testing.* Audit procedures can be followed to see if a client actually owns all of its assets. For example, inquiries can be made to see if inventory is actually owned by the client, or if it is instead being held on consignment from a third party.
- *Valuation testing.* Audit procedures are used to determine whether the valuations at which assets and liabilities are recorded in a client's books are correct. For example, one procedure would be to check market pricing data to see if the ending values of marketable securities are correct. A complete set of audit procedures is needed before the auditor has enough information to decide whether a client's financial statements fairly represent its financial results, financial position, and cash flows.

➤ **Statutory audit**

Audit of Financial statements required by the Statute governing that organization as per the provisions of same statute. A statute is the particular law or Act governing a particular organization. Say for e.g., a company is governed by Companies Act, a trust is governed by Trust Act, Bank by RBI Act, NBFC by RBI Act and Companies Act etc. So it the requirement of that particular act that the organization needs to get its accounts audited. A statutory audit is a compulsory audit, except for a few exemptions as may have been provided in the Act itself.

➤ **Non Statutory Audit**

Non statutory audit is a process of review and verification of a company's business and it is not required by any law or statute. This type of audit is performed to identify the weakness of an organization which may hamper productivity and efficiency level of the business.

➤ **True and fair view**

True and fair view in auditing means that the financial statements are free from material misstatements and faithfully represent the financial performance and position of the entity.

➤ **Audit Strategy**

An audit strategy sets the direction, timing, and scope of an audit. The strategy is then used as a guideline when developing an audit plan. The strategy document usually includes a statement of the key decisions needed to properly plan the audit. The audit strategy is based on the following considerations:

- The characteristics of the engagement
- Reporting objectives
- Timing of the audit
- Nature of communications
- Significant factors in directing engagement team efforts
- The results of preliminary engagement activities
- The knowledge gained on other engagements
- The nature, timing, and extent of resources available for the engagement

The audit strategy could be relatively short for the audit of a smaller entity, perhaps in the form of a brief memo. If there are unexpected changes in conditions or the outcome of audit procedures, it may be necessary to alter the audit strategy. If there is an alteration, the reasons for the alteration should be stated in the accompanying documentation.

The audit plan is much more detailed than the strategy document, since the plan states the nature, timing, and extent of the specific audit procedures to be conducted by the audit team.

➤ **Audit Plan**

An Audit plan is the specific guideline to be followed when conducting an audit. It helps the auditor obtain sufficient appropriate evidence for the circumstances, helps keep audit costs at a reasonable level, and helps avoid misunderstandings with the client.

It addresses the specifics of what, where, who, when and how:

- What are the audit objectives?
- Where will the audit be done? (i.e. scope)
- When will the audit(s) occur? (How long?)
- Who are the auditors?
- How will the audit be done?

➤ **Substantive Testing**

Substantive testing is an audit procedure that examines the financial statements and supporting documentation to see if they contain errors. These tests are needed as evidence to support the assertion that the financial records of an entity are complete, valid, and accurate.

There are many substantive tests that an auditor can use. The following list is a sampling of the available tests:

- Conduct a bank confirmation to test ending cash balances
- Contact customers to confirm that accounts receivable balances are correct
- Observe the period-end counting of inventory
- Confirm the validity of inventory valuation calculations
- Confirm with experts that the fair values assigned to assets obtained through a business combination are reasonable
- Physically match fixed assets to fixed asset records
- Contact suppliers to confirm that accounts payable balances are correct
- Contact lenders to confirm that loan balances are correct
- Review board of directors minutes to verify the existence of approved dividends

As indicated by the examples, substantive testing is likely to include confirmation of account balances with third parties (such as confirming receivables), recalculating calculations made by the client (such as valuing inventory), and observing transactions being performed (such as the physical inventory count). If substantive testing turns up errors or misstatements, additional audit testing may be required. In addition, a summary of any errors found is included in a management letter that is shared with the client's audit committee.

Substantive testing may also be conducted by a company's internal audit staff. Doing so can provide assurance that internal recordation systems are performing as planned. If not, the systems can be improved to eliminate the issues, thereby providing for a cleaner audit when the external auditors conduct their tests at year-end. Internally-conducted substantive testing may occur throughout the year.

➤ **Audit sampling and its Methods**

Audit sampling can be defined as the process of applying auditing procedures to under 100% of different items in an organization's account balance in a way that every single unit might have an equal probability of being selected.

Techniques for Audit Sampling

There are certain important sampling techniques that can be adopted by an auditor. These include:

- *Haphazard sampling*

The haphazard sampling technique is the one adopted by the auditor in cases where the sample does not follow a structured technique. Haphazard sampling is, however, not appropriate during the use of statistical sampling. Besides, it is also important for the auditor to always ascertain that haphazard sampling is not 'doctored' in a way that by design avoids sampling items which, for instance, are difficult to locate. All items in the population should get a chance of being selected.

- *Stratified sampling*

This sampling technique involves the auditor to split items included in a sample into their different sections. For instance, in a payroll sample the auditor might divide the sample in full-time males, full-time females, part-time males, and part-time females thus working out the percentage of sections in the population.

- *Systematic sampling*

The systematic sampling is also referred as 'interval' sampling. This sampling technique involves the auditor to take the number of sampling units in the population and segregate this into the sample size so as to provide a sampling interval. In a sales invoice, for example, where the sampling interval is 25, the auditor will determine an initial point for sampling and subsequently sample every 25th sales invoice.

- *Block sampling*

Block sampling is a sampling technique wherein the auditor applies measures to such items which occur in the same block of sequence or time. However, the block sampling technique should be used with caution as valid references cannot possibly be made beyond the examined period or block.

- *Judgment*

This sampling technique allows the auditor to use his judgment in making selection of samples. The basic issues influencing the selection of sample are:

- value of the items
- relative risk involved
- representativeness of the sample

➤ **Risk of Material Misstatement**

The risk of material misstatement is the risk that the financial statements of an organization have been misstated to a material degree. This risk is assessed by auditors at the following two levels:

- *At the assertion level.* This is further subdivided into inherent risk and control risk. Inherent risk is the susceptibility of an assertion to misstatement because of error or fraud, before considering controls. Control risk is the risk of misstatement that will not be prevented or detected by a reporting entity's internal controls.
- *At the financial statement level.* Relates to the financial statements as a whole. This risk is more likely when there is a possibility of fraud.

When the risk of material misstatement is high, the level of detection risk is lowered (increases the amount of evidence obtained from substantive procedures). Doing so reduces the overall audit risk.

➤ **Analytical procedures**

Analytical procedures are a type of evidence used during an audit. These procedures can indicate possible problems with the financial records of a client, which can then be investigated more thoroughly. Analytical procedures involve comparisons of different sets of financial and operational information, to see if historical relationships are continuing forward into the period under review. In most cases, these relationships should remain consistent over time. If not, it can imply that the financial records are incorrect, possibly due to errors or fraudulent reporting activity.

Examples of analytical procedures are as follows:

- Compare the day's sales outstanding metric to the amount for prior years. This relationship between receivables and sales should remain about the same over time, unless there have been changes in the customer base, the credit policy of the organization, or its collection practices. This is a form of ratio analysis.
- Review the current ratio over several reporting periods. This comparison of current assets to current liabilities should be about the same over time, unless the entity has altered its policies related to accounts receivable, inventory, or accounts payable. This is a form of ratio analysis.
- Compare the ending balances in the compensation expense account for several years. This amount should rise somewhat with inflation. If not, there is a chance that fraudulent payments are being made to fake employees through the payroll system. This is a form of trend analysis.
- Examine a trend line of bad debt expenses. This amount should vary in relation to sales. If not, management may not be correctly recognizing bad debts in a timely manner. This is a form of trend analysis.
- Multiply the number of employees by average pay to estimate the total annual compensation, and then compare the result to the actual total compensation expense for the period. The client must explain any material difference from this amount, such as bonus payments or employee leave without pay. This is a form of reasonableness test.

When the results of these procedures are materially different from expectations, the auditor should discuss them with management. A certain amount of skepticism is needed when having this discussion, since management may not want to spend the time to delve into a detailed explanation, or may be hiding fraudulent behavior. Management responses should be documented, and could be valuable as a baseline when conducting the same analysis in the following year.

Auditors are required to engage in analytical procedures as part of an audit engagement.

➤ **Financial audit**

A financial audit is an independent, objective evaluation of an organization's financial reports and financial reporting processes. The primary purpose for financial audits is to give regulators, investors, directors, and manager's reasonable assurance that financial statements are accurate and complete.

➤ **MIS**

MIS is short for management information system or management information services. Management information system, or MIS, broadly refers to a computer-based system that provides managers with the tools to organize, evaluate and efficiently manage departments within an organization.

➤ **Control risk**

The risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

➤ **Materiality (Audit)**

It is the matter for the auditor to decide whether a particular misstatement or an item has material impact on the financial statements or not. **Audit Objective and Materiality:** ... The materiality concept has an important role in relation to the true and fair presentation of the financial statements.

➤ **Steps of Audit Process**

There are six specific steps in the audit process that should be followed to ensure a successful audit.

Requesting Documents

After notifying the organization of the upcoming audit, the auditor typically requests documents listed on an audit preliminary checklist. These documents may include a copy of the previous audit report, original bank statements, receipts and ledgers. In addition, the auditor may request organizational charts, along with copies of board and committee minutes and copies of bylaws and standing rules.

Preparing an Audit Plan

The auditor looks over the information contained in the documents and plans out how the audit will be conducted. A risk workshop may be conducted to identify possible problems. An audit plan is then drafted.

Scheduling an Open Meeting

Senior management and key administrative staff are then invited to an open meeting during which the scope of the audit is presented by the auditor. A time frame for the audit is determined, and any timing issues such as scheduled vacations are discussed and handled. Department heads may be asked to inform staff of possible interviews with the auditor.

Conducting Fieldwork

The auditor takes information gathered from the open meeting and uses it to finalize the audit plan. Fieldwork is then conducted by speaking to staff members and reviewing procedures and processes. The auditor tests for compliance with policies and procedures. Internal controls are evaluated to make sure they're adequate. The auditor may discuss problems as they arise to give the organization an opportunity to respond.

Drafting a Report

The auditor prepares a report detailing the findings of the audit. Included in the report are mathematical errors, posting problems, payments authorized but not paid and other discrepancies; other audit concerns are also listed. The auditor then writes up a commentary describing the findings of the audit and recommended solutions to any problems.

Setting Up a Closing Meeting

The auditor solicits a response from management that indicates whether it agrees or disagrees with problems in the report, a description of management's action plan to address the problem and a projected completion date. At the closing meeting, all parties involved discuss the report and management responses. If there are any remaining issues, they're resolved at this point.

➤ **Most likely error**

1. Insufficient control over the creation of forms of financial statements
2. In the creation of accounting reports receivables and payables are distorted (increased or decreased)
3. The Company does not accrue the necessary reserves – provision for doubtful accounts, provision for impairment of tangible assets
4. Companies accrue a deferred tax asset in the reporting of tax losses without assessing the possibility of using the asset
5. Incorrectly determined date of posting tangible assets when importing goods
6. Companies do not reflect as part of fixed assets those assets for which ownership has not been transferred
7. Companies do not reflect expenses in accounting before obtaining primary documents from suppliers
8. Companies pay a bonus to the head without the written approval of the owner
9. Companies do not reflect in income fines and penalties awarded by a court
10. Companies do not use “thin capitalization” rules for the calculation of interest on controlled debt

➤ **Audit evidence and its types**

The information collected for review of a company's financial transactions, internal control practices, and other factors necessary for the certification of financial statements by a certified public accountant. The amount and type of auditing evidence considered varies considerably based on the type of firm being audited as well as the required scope of the audit. Following are types of audit evidence

- Physical examination
- Confirmation
- Documentation
- Analytical procedures
- Inquiries of the Client
- Recalculation
- Re performance
- Observation

➤ **Expected Error**

Tolerable error is considered during the planning stage and, for substantive procedures, is related to the auditors' judgment about materiality. Sampling risk can be contrasted with non-sampling risk which arises when auditors use any audit procedures.

➤ **Difference between chartered and certified**

➤ **Who review the audit report?**

A review provides limited assurance on an organization's financial statements. During a review, inquiries and analytical procedures present a reasonable basis for expressing limited assurance that no material modifications to the financial statements are necessary; they are in conformity with generally accepted accounting principles. This "does it make sense" analysis is useful when the organization needs some assurance about their financial statements, but not the higher level of assurance provided by an audit.

➤ **3 E's of Performance Audit**

- Economy
- Efficiency
- Effectiveness

➤ **Professional Skepticism**

Professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

➤ **Inherent risk**

Inherent risk is the risk posed by an error or omission in a financial statement due to a factor other than a failure of control. In a financial audit, inherent risk is most likely to occur when transactions are complex, or in situations that require a high degree of judgment in regards to financial estimates.

➤ **Systematic Risk**

Systematic risk, or market risk, is the risk that occurs because investments are part of a market system. It takes into consideration all the fluctuations of the whole market. Portfolio diversification does not help reduce systematic risk for the most part because it is an accumulation of all the events that affect the market. Factors influencing systemic risk include political events, wars, recessions and interest rates.

Economics, Finance, Economy of Pakistan and Different Economies

➤ **Economics**

Economics is a social science concerned with the production, distribution and consumption of goods and services. It studies how individuals, businesses, governments and nations make choices on allocating resources to satisfy their wants and needs, and tries to determine how these groups should organize and coordinate efforts to achieve maximum output.

Economic analysis often progresses through deductive processes, much like mathematical logic, where the implications of specific human activities are considered in a "means-ends" framework.

Economics can generally be broken down into macroeconomics, which concentrates on the behavior of the aggregate economy, and microeconomics, which focuses on individual consumers.

Prof. Adam Smith

Adam Smith wrote a book in 1776 whose title was "Wealth of Nations". In his book he discussed the word 'wealth' through its four aspects: production of wealth, exchange of wealth, distribution of wealth and consumption of wealth. Therefore it can be said according to Adam Smith: "Economics is a science of wealth". Wealth means goods and services transacted with the help of money. According to Adam Smith "Economics was concerned with, An Enquiry into the Nature and Causes of Wealth of Nations." As per definition of Adam Smith a key position was assigned to wealth in the study of Economics. The first person who introduced "Economics" as a subject was Adam Smith (1723-1790).

Prof. Alfred Marshall

Economics is the study of man in ordinary business of life. It enquires how he gets his income and here he uses it. It examines that part of individual and social action, which is most closely connected with the attainment and with the use of material requisites of well-being.....It is the study of wealth on one side and on the other side, which is more important, it is a part of the study of man.

Prof. Lionel Robbins

Economics is a science which studies human behavior as a relationship between ends and scarce means which have alternative uses.

➤ **Micro Economics**

Microeconomics focuses on how individual consumers and producers make their decisions. This includes a single person, a household, a business or a governmental organization. Microeconomics ranges from how these individuals trade with one another to how prices are affected by the supply and demand of goods. Also studied are the efficiency and costs associated with producing goods and services, how labor is divided and allocated, uncertainty, risk, and strategic game theory.

➤ **Macro Economics**

Macroeconomics studies the overall economy. This can include a distinct geographical region, a country, a continent or even the whole world. Topics studied include government fiscal and monetary policy, unemployment rates, growth as reflected by changes in the Gross Domestic Product (GDP) and business cycles that result in expansion, booms, recessions and depressions.

➤ **Comparative advantage**

Comparative advantage is an economic law referring to the ability of any given economic actor to produce goods and services at a lower opportunity cost than other economic actors. The law of comparative advantage is popularly attributed to English political economist David Ricardo and his book "Principles of Political Economy and Taxation" in 1817, although it is likely that Ricardo's mentor James Mill originated the analysis.

➤ **Budget (Deficit / Surplus)**

A budget is a quantitative expression of a plan for a defined period of time. An estimation of the revenue and expenses over a specified future period of time. A surplus budget means profits are anticipated, while a balanced budget means that revenues are expected to equal expenses. A deficit budget means expenses will exceed revenues.

➤ **Zero-based Budgeting**

Zero-based budgeting (ZBB) is a method of budgeting in which all expenses must be justified for each new period. Zero-based budgeting starts from a "zero base," and every function within an organization is analyzed for its needs and costs.

➤ **Sales Budget**

The sales budget contains an itemization of a company's sales expectations for the budget period, in both units and dollars.

➤ **Production Budget**

The production budget calculates the number of units of products that must be manufactured, and is derived from a combination of the sales forecast and the planned amount of finished goods inventory to have on hand (usually as safety stock to cover for unexpected increases in demand).

➤ **Budget cycle**

Period between one budget and the next.

A business's budget cycle is the time frame a budget covers, with companies using monthly, quarterly and/or annual budget cycles to control costs and streamline administrative duties.

Understanding the purpose of a budget cycle and the types used will help you decide how to implement one or more for your overall business or across your departments.

➤ **Budget Variance report**

The Budget Variance report shows you how expenses compare to budgets for the segments in the budget definition.

The Budget Variance Report is the main report you need for managing budgets. It gives you an overview of your budget estimates versus actuals. The estimated budget data is taken from the Final Budgets table, not from forecasts. The actual expense values are taken from the General Ledger Staged Data table.

➤ **Preparation of Annual Budget**

Many organizations prepare budgets that they use as a method of comparison when evaluating their actual results over the next year. The process of preparing a budget should be highly regimented and follow a set schedule, so that the completed budget is ready for use by the beginning of the next fiscal year.

Here are the basic steps to follow when preparing a budget:

1. *Update budget assumptions.* Review the assumptions about the company's business environment that were used as the basis for the last budget, and update as necessary.
2. *Review bottlenecks.* Determine the capacity level of the primary bottleneck that is constraining the company from generating further sales, and define how this will impact any additional company revenue growth.
3. *Available funding.* Determine the most likely amount of funding that will be available during the budget period, which may limit growth plans.
4. *Step costing points.* Determine whether any step costs will be incurred during the likely range of business activity in the upcoming budget period, and define the amount of these costs and at what activity levels they will be incurred.
5. *Create budget package.* Copy forward the basic budgeting instructions from the instruction packet used in the preceding year. Update it by including the year-to-date actual expenses incurred in the current year, and also annualize this information for the full current year. Add a commentary to the packet, stating step costing information, bottlenecks, and expected funding limitations for the upcoming budget year.
6. *Issue budget package.* Issue the budget package personally, where possible, and answer any questions from recipients. Also state the due date for the first draft of the budget package.
7. *Obtain revenue forecast.* Obtain the revenue forecast from the sales manager, validate it with the CEO, and then distribute it to the other department managers. They use the revenue information as the basis for developing their own budgets.
8. *Obtain department budgets.* Obtain the budgets from all departments, check for errors, and compare to the bottleneck, funding, and step costing constraints. Adjust the budgets as necessary.
9. *Obtain capital budget requests.* Validate all capital budget requests and forward them to the senior management team with comments and recommendations.
10. *Update the budget model.* Input all budget information into the master budget model.
11. *Review the budget.* Meet with the senior management team to review the budget. Highlight possible constraint issues, and any limitations caused by funding limitations. Note all comments made by the management team, and forward this information back to the budget originators, with requests to modify their budgets.
12. *Process budget iterations.* Track outstanding budget change requests, and update the budget model with new iterations as they arrive.
13. *Issue the budget.* Create a bound version of the budget and distribute it to all authorized recipients.
14. *Load the budget.* Load the budget information into the financial software, so that you can generate budget versus actual reports.

The number of steps noted here may be excessive for a smaller business, where perhaps just one person is involved in the process. If so, the number of steps can be greatly compressed, to the point where a preliminary budget can possibly be prepared in a day or two.

➤ **Budget 2016-2017**

Rs 4,894.9 billion

➤ **Incremental Budget**

An incremental budget is a budget prepared using a previous period's budget or actual performance as a basis with incremental amounts added for the new budget period. Moreover it encourages "spending up to the budget" to ensure a reasonable allocation in the next period. It leads to a "spend it or lose" mentality.

➤ **Mini Budget**

An extra budget prepared by a government, usually because there are specific economic problems that need to be dealt with.

➤ **Monetary Policy**

Monetary policy is the process by which the monetary authority of a country, like the central bank or currency board, controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency.

➤ **Tools of Monetary Policy**

All central banks have three tools of monetary policy in common. Most have many more. They all work together in an economy, by managing banks' reserves.

The Fed has six major tools. First, it sets a reserve requirement, which tells banks how much of their money they must have on reserve each night. If it weren't for the reserve requirement, banks would lend 100 percent of the money you've deposited. Not everyone needs all their money each day, so it is safe for the banks to lend most of it out.

The Fed requires that banks keep 10 percent of deposits on reserve. That way, they have enough cash on hand to meet most demands for redemption. When the Fed wants to restrict liquidity, it raises the reserve requirement. The Fed only does this as a last resort because it requires a lot of paperwork.

It's much easier to manage banks' reserves using the Fed funds rate.

This is the interest rate that banks charge each other to store their excess cash overnight. The target for this rate is set at the eight annual Federal Open Market Committee meetings. The Fed funds rate impacts all other interest rates, including bank loan rates and mortgage rates.

The Fed's third tool is its discount rate. That's how it charges banks to borrow funds from the Fed's fourth tool, the discount window. The FOMC usually sets the discount rate a half-point higher than the Fed funds rate. That's because the Fed prefer banks to borrow from each other.

Fifth, the Fed uses open market operations to buy and sell Treasury and other securities from its member banks. This changes the reserve amount that banks have on hand without changing the reserve requirement.

Sixth, many central banks including the Fed use inflation targeting.

It clearly sets expectations that they want some inflation. That's because people are more likely to buy if they know prices are rising.

In addition, the Fed created many new tools to deal with the Great Recession. To find out more, see Federal Reserve Tools.

➤ **Measures of Monetary Policy**

Monetary policy refers to the efforts by governments or central banks to influence economic activity through the money supply. There are different definitions of the money supply, but it generally incorporates any cash, checks, credit accounts and other liquid, exchangeable instruments. Most of the economic tools used in monetary policy center around the creation of new money units or the control of credit accounts through interest rate changes. The efficacy of monetary policy is a controversial topic among economists and policy makers, and the exact means of implementing monetary controls varies among governments and across time.

Many modern governments separate those who enact fiscal policy, taxing and government spending, from those who control monetary policy, often delegating the latter to central banks further removed from the political process. The most basic monetary function of central banks is to increase or decrease the total money supply. According to the quantity theory of money, an increase in the money supply tends to cause inflation, while a shrinking money supply tends to cause deflation.

In practice, however, controlling the money supply can be difficult. Private lenders can actually change the amount of money in circulation through the fractional reserve banking system, and technological

innovations have introduced new means of exchange and stores of value. It can be very difficult for central banks to even measure the current money supply, let alone calculate its velocity or estimate the impact of future monetary injections.

Rather than simply printing or gathering units of currency, it is easier for central banks to use measurable metrics such as interest rates and consumer prices to set policy. This is why the Federal Reserve targets the discount rate and the federal funds rate; interest rates influence the cost of credit. Borrowing becomes cheaper when rates are lowered, and this tends to increase the amount of money in the economy through the multiplier effect. The opposite is true when rates are increased and credit is more expensive.

The Fed also sets the reserve ratio requirements for private lenders, which is the total percentage of a bank's lending assets that must be kept on deposit, not lent out, to meet demand account obligations. Banks often borrow money from each other overnight to meet these requirements, so the Fed controls how much interest can be charged on these short-term loans.

Central banks can actually enter the securities markets to influence prices and either inject or absorb money from the economy. If the Fed purchases U.S. Treasuries, for example, it increases the demand for that asset and simultaneously injects money into the market. Conversely, selling U.S. Treasuries increases supply for the asset and pulls money out of the market. This type of monetary activity is known as open market operations.

As a tool of economic reform, monetary policy is crude and inexact. Many standard measurements of economic performance, such as unemployment, inflation, total spending, capital investment, etc., are either lagging or difficult to estimate. That said, monetary policy remains one of the most important influences on modern economies and the subject of continual study.

➤ **Fiscal Policy, Types, Tools**

Fiscal policy is the government spending and taxation that influences the economy. Elected officials should coordinate with monetary policy to create healthy economic growth. They usually don't. Why? Fiscal policy reflects the priorities of individual lawmakers. They focus on the needs of their constituencies. These local needs overrule national economic priorities. As a result, fiscal policy is hotly debated, whether at the federal, state, county or municipal level.

Types of Fiscal Policy

There are two types of fiscal policy. The first, and most widely-used, is expansionary. It stimulates economic growth. It's most critical at the contraction phase of the business cycle. That's when voters are clamoring for relief from a recession.

The second type, contractionary fiscal policy, is rarely used. That's because its goal is to slow economic growth. Why would you ever want to do that? One reason only, and that's to stamp out inflation. That's because the long-term inflation can damage the standard of living as much as a recession.

Tools of Fiscal Policy

The first tool is taxation. That includes income, capital gains from investments, property, sales or just about anything else. Taxes provide the major revenue source that funds the government. The downside of taxes is that whatever or whoever is taxed has less income to spend on themselves.

That makes taxes unpopular. Find out how the U.S. federal budget is funded in Federal Income and Taxes.

The second tool is government spending. That includes subsidies, transfer payments including welfare programs, public works projects and government salaries. Whoever receives the funds has more money to spend. That increases demand and economic growth.

➤ **Determinants of economic growth**

Determinants of economic growth are inter-related factors that directly influence the rate of economic growth i.e. increase in real GDP of an economy. There are six major determinants of growth. Four of these are typically grouped under supply factors which include natural resources, human resources, capital goods and technology. The other two are demand and efficiency factors.

Supply Factors

These factors affect the value of goods and services supplied in an economy.

Natural Resources: Natural resources include anything that exists in nature and which has exploitable economic value. Rate of economic growth increases on increase in quantity and quality of natural resources. Examples of natural resources which can have major effect on rate of economic growth include fossil fuels, valuable metals, oceans, and wild life.

Human Resources: Human resources include both skilled and unskilled workforce. Increase in the quantity and quality of the workforce increases rate of economic growth. Here, increase in quality refers

to improvement of skills the workers possess. When more people work, more goods and services are produced and when more skilled workers do a job, they produce high value goods and services.

Capital Goods: Capital goods are tangible assets such as plant and machinery that can carry out processes which result in the production of other goods and services. Capital goods require big investments initially but they increase production and growth rate in future periods.

Technology: Technology includes methods and procedures used to produce various goods and services. New technology may be invented or current technology may be improved gradually by investing in research. Better techniques once devised, allow faster production and increase rate of economic growth.

Demand Factor

The increased supply of goods and services caused by the supply factors must be sustained by increased demand for goods and services in the economy.

Efficiency Factor

Achieving high output to input ratio is the result of efficiency. Efficiency includes both productive and allocative efficiency. High efficiency increases growth rate when it is coupled with full employment.

To achieve maximum growth rate, an economy must use its available resources in the least costly way to produce the optimum mix of goods and services and it must use its resources to the maximum extent possible.

➤ **Factors of productions**

Economic resources are the goods or services available to individuals and businesses used to produce valuable consumer products. The classic economic resources include land, labor and capital.

Entrepreneurship is also considered an economic resource because individuals are responsible for creating businesses and moving economic resources in the business environment. These economic resources are also called the factors of production. The factors of production describe the function that each resource performs in the business environment.

Land

Land is the economic resource encompassing natural resources found within a nation's economy. This resource includes timber, land, fisheries, farms and other similar natural resources. Land is usually a limited resource for many economies. Although some natural resources, such as timber, food and animals, are renewable, the physical land is usually a fixed resource. Nations must carefully use their land resource by creating a mix of natural and industrial uses. Using land for industrial purposes allows nations to improve the production processes for turning natural resources into consumer goods.

Labor

Labor represents the human capital available to transform raw or national resources into consumer goods. Human capital includes all able-bodied individuals capable of working in the nation's economy and providing various services to other individuals or businesses. This factor of production is a flexible resource as workers can be allocated to different areas of the economy for producing consumer goods or services. Human capital can also be improved through training or educating workers to complete technical functions or business tasks when working with other economic resources.

Capital

Capital has two economic definitions as a factor of production. Capital can represent the monetary resources companies use to purchase natural resources, land and other capital goods. Monetary resources flow through a nation's economy as individuals buy and sell resources to individuals and businesses. Capital also represents the major physical assets individuals and companies use when producing goods or services. These assets include buildings, production facilities, equipment, vehicles and other similar items. Individuals may create their own capital production resources, purchase them from another individual or business or lease them for a specific amount of time from individuals or other businesses.

Entrepreneurship

Entrepreneurship is considered a factor of production because economic resources can exist in an economy and not be transformed into consumer goods. Entrepreneurs usually have an idea for creating a valuable good or service and assume the risk involved with transforming economic resources into

consumer products. Entrepreneurship is also considered a factor of production since someone must complete the managerial functions of gathering, allocating and distributing economic resources or consumer products to individuals and other businesses in the economy.

➤ **Durable goods**

Products that aren't consumed or quickly disposed of, and can be used for several years. Also called hard goods.

➤ **Non-Durable goods**

A good which is immediately used by a consumer or which has an expected lifespan of three years or less. Examples of non-durable goods include food and clothing. Opposite of durable goods. Also called soft good.

➤ **Hedging and types**

Hedging is a risk reduction technique whereby an entity uses a derivative or similar instrument to offset future changes in the fair value or cash flows of an asset or liability. A perfect hedge eliminates the risk of a subsequent price movement. A hedged item can be any of the following individually or in a group with similar risk characteristics:

- Highly probable forecast transaction
- Net investment in a foreign operation
- Recognized asset
- Recognized liability
- Unrecognized firm commitment

Hedge effectiveness is the amount of changes in the fair value or cash flows of a hedged item that are offset by changes in the fair value or cash flows of a hedging instrument.

Hedge accounting involves matching a derivative instrument to a hedged item, and then recognizing gains and losses from both items in the same period.

Types of Hedging

Hedging can be used in many different ways including foreign exchange trading. The stock example above is a "classic" sort of hedge, known in the industry as a pairs trade due to the trading on a pair of related securities. As investors became more sophisticated, along with the mathematical tools used to calculate values (known as models), the types of hedges have increased greatly.

Examples of hedging include:

- Forward exchange contract for currencies
- Currency future contracts
- Money Market Operations for currencies
- Forward Exchange Contract for interest
- Money Market Operations for interest
- Future contracts for interest
- Covered Calls on equities
- Short Straddles on equities or indexes
- Bets on elections or sporting events

➤ **Rent theory**

Rent is that portion of the produce of the earth, which is paid to the landlord for the original and indestructible powers of the soil. It is a surplus enjoyed by the super marginal land over the marginal land arising due to the operation of the law of diminishing returns.

All the units of land are not of the same grade. They differ in fertility and location. The application of the same amount of labor, capital and other cooperating resources give rise to difference in productivity. This difference in productivity or the surplus which arises on the superior units of land over the inferior units is an economic rent.

➤ **National Income**

National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, national income means the total value of goods and services produced annually in a country.

In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

➤ **Concepts of National Income**

There are a number of concepts pertaining to national income and methods of measurement relating to them.

(A) Gross Domestic Product (GDP):

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices. Dernberg defines GDP at market price as “the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year.

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices. Dernberg defines GDP at market price as “the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year.

(B) GDP at Factor Cost:

GDP at factor cost is the sum of net value added by all producers within the country. Since the net value added gets distributed as income to the owners of factors of production, GDP is the sum of domestic factor incomes and fixed capital consumption (or depreciation).

Thus GDP at Factor Cost = Net value added + Depreciation.

(C) Net Domestic Product (NDP):

NDP is the value of net output of the economy during the year. Some of the country’s capital equipment wears out or becomes obsolete each year during the production process. The value of this capital consumption is some percentage of gross investment which is deducted from GDP. Thus Net Domestic Product = GDP at Factor Cost – Depreciation.

(D) Nominal and Real GDP:

When GDP is measured on the basis of current price, it is called GDP at current prices or nominal GDP. On the other hand, when GDP is calculated on the basis of fixed prices in some year, it is called GDP at constant prices or real GDP.

Nominal GDP is the value of goods and services produced in a year and measured in terms of rupees (money) at current (market) prices. In comparing one year with another, we are faced with the problem that the rupee is not a stable measure of purchasing power. GDP may rise a great deal in a year, not because the economy has been growing rapidly but because of rise in prices (or inflation). On the contrary, GDP may increase as a result of fall in prices in a year but actually it may be less as compared to the last year. In both 5 cases, GDP does not show the real state of the economy. To rectify the underestimation and overestimation of GDP, we need a measure that adjusts for rising and falling prices.

This can be done by measuring GDP at constant prices which is called real GDP. To find out the real GDP, a base year is chosen when the general price level is normal, i.e., it is neither too high nor too low. The prices are set to 100 (or 1) in the base year.

(E) GDP Deflator:

GDP deflator is an index of price changes of goods and services included in GDP. It is a price index which is calculated by dividing the nominal GDP in a given year by the real GDP for the same year and multiplying it by 100. Thus,

$$GDP\ Deflator = \frac{\text{Nominal (or Current Prices) GDP}}{\text{Real (or Constant Prices) GDP}} \times 100$$

$$\text{For example, GDP Deflator in 1997-98} = \frac{1426.7\text{th. crores}}{1049.2\text{th. crores at}} \times 100 = 135.9$$

It shows that at constant prices (1993-94), GDP in 1997-98 increased by 135.9% due to inflation (or rise in prices) from Rs. 1049.2 thousand crores in 1993-94 to Rs. 1426.7 thousand crores in 1997-98.

(F) Gross National Product (GNP):

GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country, including net income from abroad.

(G) GNP at Market Prices:

When we multiply the total output produced in one year by their market prices prevalent during that year in a country, we get the Gross National Product at market prices. Thus GNP at market prices means the gross value of final goods and services produced annually in a country plus net income from abroad. It

includes the gross value of output of all items from (1) to (4) mentioned under GNP. $\text{GNP at Market Prices} = \text{GDP at Market Prices} + \text{Net Income from Abroad}$.

(H) GNP at Factor Cost:

GNP at factor cost is the sum of the money value of the income produced by and accruing to the various factors of production in one year in a country. It includes all items mentioned above under income method to GNP less indirect taxes.

GNP at market prices always includes indirect taxes levied by the government on goods which raise their prices. But GNP at factor cost is the income which the factors of production receive in return for their services alone. It is the cost of production.

Thus GNP at market prices is always higher than GNP at factor cost. Therefore, in order to arrive at GNP at factor cost, we deduct indirect taxes from GNP at market prices. Again, it often happens that the cost of production of a commodity to the producer is higher than a price of a similar commodity in the market.

In order to protect such producers, the government helps them by granting monetary help in the form of a subsidy equal to the difference between the market price and the cost of production of the commodity. As a result, the price of the commodity to the producer is reduced and equals the market price of similar commodity.

For example if the market price of rice is Rs. 3 per kg but it costs the producers in certain areas Rs. 3.50. The government gives a subsidy of 50 paise per kg to them in order to meet their cost of production.

Thus in order to arrive at GNP at factor cost, subsidies are added to GNP at market prices.

$\text{GNP at Factor Cost} = \text{GNP at Market Prices} - \text{Indirect Taxes} + \text{Subsidies}$.

(I) Net National Product (NNP):

NNP includes the value of total output of consumption goods and investment goods. But the process of production uses up a certain amount of fixed capital. Some fixed equipment wears out, its other components are damaged or destroyed, and still others are rendered obsolete through technological changes.

All this process is termed depreciation or capital consumption allowance. In order to arrive at NNP, we deduct depreciation from GNP. The word 'net' refers to the exclusion of that part of total output which represents depreciation. So $\text{NNP} = \text{GNP} - \text{Depreciation}$.

(J) NNP at Market Prices:

Net National Product at market prices is the net value of final goods and services evaluated at market prices in the course of one year in a country. If we deduct depreciation from GNP at market prices, we get NNP at market prices. So $\text{NNP at Market Prices} = \text{GNP at Market Prices} - \text{Depreciation}$.

(K) NNP at Factor Cost:

Net National Product at factor cost is the net output evaluated at factor prices. It includes income earned by factors of production through participation in the production process such as wages and salaries, rents, profits, etc. It is also called National Income. This measure differs from NNP at market prices in that indirect taxes are deducted and subsidies are added to NNP at market prices in order to arrive at NNP at factor cost.

(L) Domestic Income:

Income generated (or earned) by factors of production within the country from its own resources is called domestic income or domestic product.

(M) Private Income:

Private income is income obtained by private individuals from any source, productive or otherwise, and the retained income of corporations. It can be arrived at from NNP at Factor Cost by making certain additions and deductions.

The additions include transfer payments such as pensions, unemployment allowances, sickness and other social security benefits, gifts and remittances from abroad, windfall gains from lotteries or from horse racing, and interest on public debt. The deductions include income from government departments as well as surpluses from public undertakings, and employees' contribution to social security schemes like provident funds, life insurance, etc.

Thus $\text{Private Income} = \text{National Income (or NNP at Factor Cost)} + \text{Transfer Payments} + \text{Interest on Public Debt} - \text{Social Security} - \text{Profits and Surpluses of Public Undertakings}$.

(N) Personal Income:

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in one year. Personal income is never equal to the national income, because the former includes the transfer payments whereas they are not included in national income.

Personal income is derived from national income by deducting undistributed corporate profits, profit taxes, and employees' contributions to social security schemes. These three components are excluded from national income because they do not reach individuals.

But business and government transfer payments, and transfer payments from abroad in the form of gifts and remittances, windfall gains, and interest on public debt which are a source of income for individuals are added to national income. Thus $\text{Personal Income} = \text{National Income} - \text{Undistributed Corporate Profits} - \text{Profit Taxes} - \text{Social Security Contribution} + \text{Transfer Payments} + \text{Interest on Public Debt}$.

Personal income differs from private income in that it is less than the latter because it excludes undistributed corporate profits.

Thus $\text{Personal Income} = \text{Private Income} - \text{Undistributed Corporate Profits} - \text{Profit Taxes}$.

(O) Disposable Income:

Disposable income or personal disposable income means the actual income which can be spent on consumption by individuals and families. The whole of the personal income cannot be spent on consumption, because it is the income that accrues before direct taxes have actually been paid.

Therefore, in order to obtain disposable income, direct taxes are deducted from personal income. Thus $\text{Disposable Income} = \text{Personal Income} - \text{Direct Taxes}$.

But the whole of disposable income is not spent on consumption and a part of it is saved. Therefore, disposable income is divided into consumption expenditure and savings. Thus $\text{Disposable Income} = \text{Consumption Expenditure} + \text{Savings}$.

If disposable income is to be deduced from national income, we deduct indirect taxes plus subsidies, direct taxes on personal and on business, social security payments, undistributed corporate profits or business savings from it and add transfer payments and net income from abroad to it.

Thus $\text{Disposable Income} = \text{National Income} - \text{Business Savings} - \text{Indirect Taxes} + \text{Subsidies} - \text{Direct Taxes on Persons} - \text{Direct Taxes on Business} - \text{Social Security Payments} + \text{Transfer Payments} + \text{Net Income from abroad}$.

(P) Real Income:

Real income is national income expressed in terms of a general level of prices of a particular year taken as base. National income is the value of goods and services produced as expressed in terms of money at current prices. But it does not indicate the real state of the economy.

It is possible that the net national product of goods and services this year might have been less than that of the last year, but owing to an increase in prices, NNP might be higher this year. On the contrary, it is also possible that NNP might have increased but the price level might have fallen, as a result national income would appear to be less than that of the last year. In both the situations, the national income does not depict the real state of the country. To rectify such a mistake, the concept of real income has been evolved.

In order to find out the real income of a country, a particular year is taken as the base year when the general price level is neither too high nor too low and the price level for that year is assumed to be 100. Now the general level of prices of the given year for which the national income (real) is to be determined is assessed in accordance with the prices of the base year. For this purpose the following formula is employed.

$\text{Real NNP} = \text{NNP for the Current Year} \times \text{Base Year Index} (=100) / \text{Current Year Index}$

Suppose 1990-91 is the base year and the national income for 1999-2000 is Rs. 20,000 crores and the index number for this year is 250. Hence, Real National Income for 1999-2000 will be $= 20000 \times 100/250 = \text{Rs. } 8000 \text{ crores}$. This is also known as national income at constant prices.

(Q) Per Capita Income:

The average income of the people of a country in a particular year is called Per Capita Income for that year. This concept also refers to the measurement of income at current prices and at constant prices. For instance, in order to find out the per capita income for 2001, at current prices, the national income of a country is divided by the population of the country in that year.

$$\text{Per Capita Income for 2001} = \frac{\text{National income for 2001}}{\text{Population in 2001}}$$

Similarly, for the purpose of arriving at the Real Per Capita Income, this very formula is used.

$$\text{Real Per Capita Income for 2001} = \frac{\text{Real national income for 2001}}{\text{Population in 2001}}$$

This concept enables us to know the average income and the standard of living of the people. But it is not very reliable, because in every country due to unequal distribution of national income, a major portion of it goes to the richer sections of the society and thus income received by the common man is lower than the per capita income.

➤ Economics Indicator

An **economic indicator** is a statistic about an economic activity. Economic indicators allow analysis of economic performance and predictions of future performance. One application of economic indicators is the study of business cycles. Economic indicators include various indices, earnings reports, and economic summaries. Examples: unemployment rate, quits rate (quit rate in U.S. English), housing starts, consumer price index (a measure for inflation), consumer leverage ratio, industrial production, bankruptcies, gross domestic product, broadband internet penetration, retail sales, stock market prices, money supply changes.

Economic indicators can be classified into three categories according to their usual timing in relation to the business cycle: leading indicators, lagging indicators, and coincident indicators.

Leading indicators

Leading indicators are indicators that usually, but not always, change before the economy as a whole changes. They are therefore useful as short-term predictors of the economy. Stock market returns are a leading indicator: the stock market usually begins to decline before the economy as a whole declines and usually begins to improve before the general economy begins to recover from a slump. Other leading indicators include the index of consumer expectations, building permits, and the money supply. The Conference Board publishes a composite Leading Economic Index consisting of ten indicators designed to predict activity in the U. S. economy six to nine months in future.

Components of the Conference Board's Leading Economic Indicators Index

1. **Average weekly hours (manufacturing)** — Adjustments to the working hours of existing employees are usually made in advance of new hires or layoffs, which is why the measure of average weekly hours is a leading indicator for changes in unemployment.
2. **Average weekly jobless claims for unemployment insurance** — The CB reverses the value of this component from positive to negative because a positive reading indicates a loss in jobs. The initial jobless-claims data is more sensitive to business conditions than other measures of unemployment, and as such leads the monthly unemployment data released by the U.S. Department of Labor.
3. **Manufacturers' new orders for consumer goods/materials** — this component is considered a leading indicator because increases in new orders for consumer goods and materials usually mean positive changes in actual production. The new orders decrease inventory and contribute to unfilled orders, a precursor to future revenue.
4. **Vendor performance (slower deliveries diffusion index)** — This component measures the time it takes to deliver orders to industrial companies. Vendor performance leads the business cycle because an increase in delivery time can indicate rising demand for manufacturing supplies. Vendor performance is measured by a monthly survey from the National Association of Purchasing Managers (NAPM). This diffusion index measures one-half of the respondents reporting no change and all respondents reporting slower deliveries.
5. **Manufacturers' new orders for non-defense capital goods** — As stated above, new orders lead the business cycle because increases in orders usually mean positive changes in actual production and perhaps rising demand. This measure is the producer's counterpart of new orders for consumer goods/materials component (#3).
6. **Building permits** for new private housing units.
7. The **Standard & Poor's 500 stock index** — The S&P 500 is considered a leading indicator because changes in stock prices reflect investor's expectations for the future of the economy and interest rates. Corporate equities as leading indicator with respect to GDP.
8. **Money Supply (M2)** — The money supply measures demand deposits, traveler's checks, savings deposits, currency, money market accounts, and small-denomination time deposits. Here, M2 is adjusted for inflation by means of the deflator published by the federal government in the GDP report. Bank lending, a factor contributing to account deposits, usually declines when inflation increases faster than

the money supply, which can make economic expansion more difficult. Thus, an increase in demand deposits will indicate expectations that inflation will rise, resulting in a decrease in bank lending and an increase in savings.

9. **Interest rate spread** (10-year Treasury vs. Federal Funds target) — The interest rate spread is often referred to as the yield curve and implies the expected direction of short-, medium- and long-term interest rates. Changes in the yield curve have been the most accurate predictors of downturns in the economic cycle. This is particularly true when the curve becomes inverted, that is, when the longer-term returns are expected to be less than the short rates.
10. **Index of consumer expectations** — This is the only component of the leading indicators that is based solely on expectations. This component leads the business cycle because consumer expectations can indicate future consumer spending or tightening. The data for this component comes from the University of Michigan's Survey Research Center, and is released once a month.

Lagging indicators

Lagging indicators are indicators that usually change after the economy as a whole does. Typically the lag is a few quarters of a year. The unemployment rate is a lagging indicator: employment tends to increase two or three quarters after an upturn in the general economy. In finance, Bollinger bands are one of various lagging indicators in frequent use. In a performance measuring system, profit earned by a business is a lagging indicator as it reflects a historical performance; similarly, improved customer satisfaction is the result of initiatives taken in the past.

The Index of Lagging Indicators is published monthly by The Conference Board, a non-governmental organization, which determines the value of the index from seven components.

The Index tends to *follow* changes in the overall economy.

The components on the Conference Board's index are:

- The average duration of unemployment (inverted)
- The value of outstanding commercial and industrial loans
- The change in the Consumer Price Index for services
- The change in labour cost per unit of output
- The ratio of manufacturing and trade inventories to sales
- The ratio of consumer credit outstanding to personal income
- The average prime rate charged by banks

Federal Funds Rate in the USA lagging behind capacity utilization in manufacturing.

Coincident indicators

Coincident indicators change at approximately the same time as the whole economy, thereby providing information about the current state of the economy. There are many coincident economic indicators, such as Gross Domestic Product, industrial production, personal income and retail sales. A coincident index may be used to identify, after the fact, the dates of peaks and troughs in the business cycle.^[2] There are four economic statistics comprising the Index of Coincident Economic Indicators.

- Number of employees on non-agricultural payrolls
- Personal income less transfer payments
- Industrial production
- Manufacturing and trade sale

The Philadelphia Federal Reserve produces state-level coincident indexes based on 4 state-level variables:

- Nonfarm payroll employment
- Average hours worked in manufacturing
- Unemployment rate
- Wage and salary disbursements deflated by the consumer price index (U.S. city average)

➤ Sunk cost

A sunk cost, also known as a stranded cost, is an expense that has already occurred and can't be changed or avoided. In other words, it's a cost that has already been paid and can't be refunded or reduced. It's in the past and has no bearing on any future decision making processes.

➤ Opportunity Cost

A benefit, profit, or value of something that must be given up to acquire or achieve something else. Since every resource (land, money, time, etc.) can be put to alternative uses, every action, choice, or decision has an associated opportunity cost.

Opportunity costs are fundamental costs in economics, and are used in computing cost benefit analysis

of a project. Such costs, however, are not recorded in the account books but are recognized in decision making by computing the cash outlays and their resulting profit or loss.

➤ **Utility**

Utility is the capacity of a commodity through which human wants are satisfied.

➤ **Law of Diminishing marginal utility**

The law of diminishing marginal utility is comprehensively explained by Alfred Marshall. According to his definition of the law of diminishing marginal utility, the following happens:

“During the course of consumption, as more and more units of a commodity are used, every successive unit gives utility with a diminishing rate, provided other things remaining the same; although, the total utility increases.”

Assumptions of Law of Diminishing Marginal Utility:

The law of diminishing marginal utility is true under certain assumptions. These assumptions are as under:

(i) **Rationality:** In the cardinal utility analysis, it is assumed that the consumer is rational. He aims at maximization of utility subject to availability of his income.

(ii) **Constant marginal utility of money:** It is assumed in the theory that the marginal utility of money based for purchasing goods remains constant. If the marginal utility of money changes with the increase or decrease in income, it then cannot yield correct measurement of the marginal utility of the good.

(iii) **Diminishing marginal utility:** Another important assumption of utility analysis is that the utility gained from the successive units of a commodity diminishes in a given time period.

(iv) **Utility is additive:** In the early versions of the theory of consumer behavior, it was assumed that the utilities of different commodities are independent. The total utility of each commodity is additive.

$$U = U^1 (X^1) + U^2 (X^2) + U^3 (X^3)..... U^n (X^n)$$

(v) **Consumption to be continuous:** It is assumed in this law that the consumption of a commodity should be continuous. If there is interval between the consumption of the same units of the commodity, the law may not hold good. For instance, if you take one glass of water in the morning and the 2nd at noon, the marginal utility of the 2nd glass of water may increase.

(vi) **Suitable quantity:** It is also assumed that the commodity consumed is taken in suitable and reasonable units. If the units are too small, then the marginal utility instead of falling may increase up to a few units.

(vii) **Character of the consumer does not change:** The law holds true if there is no change in the character of the consumer. For example, if a consumer develops a taste for wine, the additional units of wine may increase the marginal utility to a drunkard.

(viii) **No change to fashion:** Customs and tastes: If there is a sudden change in fashion or customs or taste of a consumer, it can then make the law inoperative.

(ix) **No change in the price of the commodity:** there should be any change in the price of that commodity as more units are consumed.

➤ **Balance of Trade (Favorable/ Trade Surplus, Unfavorable/ Trade Deficit)**

The balance of trade compares the value of a country's exports of goods and services against its imports. When exports are greater than imports, that's a trade surplus. Most nations view that as a favorable trade balance. The opposite, when the value of imports outweighs the value of exports, is a trade deficit. Countries usually regard that as an unfavorable trade balance.

To determine whether a country truly has a favorable trade balance, you must answer three questions. First, where is the country in its business cycle? Second, how long has the deficit or surplus been ongoing? Third, what are the reasons behind it?

➤ **Balance of Payment**

The **balance of payments** (BOP) records all financial transactions made between consumers, businesses and the government in one country with other countries.

- The BOP figures tell us about how much is being spent by consumers and firms on imported goods and services, and how successful firms have been in exporting to other countries.
- **Inflows** of foreign currency are counted as a positive entry (e.g. exports sold overseas)
- **Outflows** of foreign currency are counted as a negative entry (e.g. imported goods and services)

What is the basic structure of the balance of payments accounts?

Current Account

1. Balance of trade in **goods**
2. Balance of trade in **services**

3. **Net primary income** (this includes incomes from interest, profits, dividends generated from foreign investment and also migrant remittances i.e. payments from people living and working overseas)
4. Net secondary income (this includes (for the UK) our annual contributions to EU, spending military aid, overseas development aid etc.)

Capital account

- Sale/transfer of patents, copyrights, franchises, leases and other transferable contracts, and goodwill
- Transfers of ownership of fixed assets

Financial Account

This includes transactions that result in a change of ownership of financial assets and liabilities between UK residents and non-residents

- Net balance of foreign direct investment flows (FDI)
- Net balance of portfolio flows (e.g. inflows and outflows of debt and equity)
- Balance of banking flows (e.g. hot money flowing in/out of banking system) **Balancing item** (estimated errors & omissions)

Changes to the value of reserves of gold and foreign currency Overall balance of payments = zero

➤ **Inflation**

Inflation is defined as a sustained increase in the general level of prices for goods and services in a country, and is measured as an annual percentage change. Under conditions of inflation, the prices of things rise over time. Put differently, as inflation rises, every dollar you own buys a smaller percentage of a good or service. When prices rise, and alternatively when the value of money falls you have inflation.

➤ **Causes of Inflation**

There is no single theory for the cause of inflation that is universally agreed upon by economists and academics, but there are a few hypotheses that are commonly held.

Demand-Pull Inflation – Inflation is caused by the overall increase in demand for goods and services, which bids up their prices. This theory can be summarized as "too much money chasing too few goods". In other words, if demand is growing faster than supply, prices will increase. This usually occurs in rapidly growing economies. This theory is often promoted by the Keynesian school of economics.

Cost-Push Inflation – Inflation is caused when companies' costs of production go up. When this happens, they need to increase prices to maintain their profit margins. Increased costs can include things such as wages, taxes, or increased costs of natural resources or imports.

Monetary Inflation – Inflation is caused by an oversupply of money in the economy. Just like any other commodity, the prices of things are determined by their supply and demand. If there is too much supply, the price of that thing goes down. If that thing is money, and too much supply of money makes its value go down, the result is that the prices of everything else priced in dollars must go up! This theory is often promoted by the "Monetarist" school of economics.

➤ **Deflation**

Deflation is when the general level of prices are falling. It is the opposite effect of inflation. Deflation tends to occur more rarely and for shorter periods of time than inflation. Deflation occurs typically during times of recession or economic crisis and can lead to deep economic crises including depression.

➤ **Disinflation**

Disinflation is a condition where inflation is still positive, but the rate of inflation is decreasing – for example from +3% to +2%.

➤ **Hyperinflation**

Hyperinflation is unusually rapid inflation, typically more than 50% in a single month. In extreme cases, this inflation gone awry can lead to the breakdown of a nation's monetary system or even its economy. One of the most notable examples of hyperinflation occurred in Germany in 1923, when prices rose 2,500% in one month!

➤ **Stagflation**

Stagflation is the rare combination of high unemployment and economic stagnation along with high rates of inflation. This happened in industrialized countries during the 1970s, when a rocky economy was confronted with OPEC raising oil prices resulting in a demand shock for oil. This sent the price of oil – and all of the products and services that use oil as an input – higher, even as the economy slackened.

➤ **Market**

A **market** is a location where buyers and sellers meet to exchange goods and services at prices determined by the forces of supply and demand.

➤ **Market equilibrium**

Market equilibrium is a market state where the supply in the market is equal to the demand in the market. The equilibrium price is the price of a good or service when the supply of it is equal to the demand for it in the market.

➤ **Perfect Competition**

Perfect competition describes a market structure where competition is at its greatest possible level. To make it more clear, a market which exhibits the following characteristics in its structure is said to show perfect competition:

1. Large number of buyers and sellers
2. Homogenous product is produced by every firm
3. Free entry and exit of firms
4. Zero advertising cost
5. Consumers have perfect knowledge about the market and are well aware of any changes in the market. Consumers indulge in rational decision making.
6. All the factors of production, viz. labour, capital, etc, have perfect mobility in the market and are not hindered by any market factors or market forces.
7. No government intervention
8. No transportation costs
9. Each firm earns normal profits and no firms can earn super-normal profits.
10. Every firm is a price taker. It takes the price as decided by the forces of demand and supply. No firm can influence the price of the product.

➤ **Monopoly**

A market structure characterized by a single seller, selling a unique product in the market. In a monopoly market, the seller faces no competition, as he is the sole seller of goods with no close substitute.

In a monopoly market, factors like government license, ownership of resources, copyright and patent and high starting cost make an entity a single seller of goods. All these factors restrict the entry of other sellers in the market. Monopolies also possess some information that is not known to other sellers. Characteristics associated with a monopoly market make the single seller the market controller as well as the price maker. He enjoys the power of setting the price for his goods.

➤ **Imperfect Competition**

Imperfect competition is a competitive market situation where there are many sellers, but they are selling heterogeneous (dissimilar) goods as opposed to the perfect competitive market scenario. As the name suggests, competitive markets that are imperfect in nature.

Imperfect competition is the real world competition. Today some of the industries and sellers follow it to earn surplus profits. In this market scenario, the seller enjoys the luxury of influencing the price in order to earn more profits.

If a seller is selling a non-identical good in the market, then he can raise the prices and earn profits.

High profits attract other sellers to enter the market and sellers, who are incurring losses, can very easily exit the market.

➤ **Monopolistic Competition**

Monopolistic competition is a type of imperfect competition such that many producers sell products that are differentiated from one another (e.g. by branding or quality) and hence are not perfect substitutes.

➤ **Oligopoly**

Oligopoly is a market structure in which a small number of firms has the large majority of market share. An oligopoly is similar to a monopoly, except that rather than one firm, two or more firms dominate the market.

➤ **Monopsony**

A monopsony, sometimes referred to as a buyer's monopoly, is a market condition similar to a monopoly except that a large buyer, not a seller, controls a large proportion of the market and drives

prices down. A monopsony occurs when a single firm has market power in employing its factors of production.

➤ **Oligopsony**

Oligopsony is similar to an oligopoly (few sellers), this is a market in which there are only a few large buyers for a product or service. This allows the buyers to exert a great deal of control over the sellers and can effectively drive down prices.

➤ **Direct Tax**

A direct tax will refer to any levy that is both imposed and collected on a specific group of people or organizations. An example of direct taxation would be income taxes that are collected from the people who actually earn their income.

➤ **Indirect Taxation**

Indirect taxes are collected from someone or some organization other than the person or entity that would normally be responsible for the taxes.

A sales tax, for instance, would not be considered a direct tax because the money is collected from merchants, not from the people who actually pay the tax (the consumers).

➤ **Progressive Tax**

Progressive tax is the taxing mechanism in which the taxing authority charges more taxes as the income of the taxpayer increases. A higher tax is collected from the taxpayers who earn more and lower taxes from taxpayers earning less.

➤ **Regressive Tax**

A regressive tax is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases. "Regressive" describes a distribution effect on income or expenditure, referring to the way the rate progresses from high to low, so that the average tax rate exceeds the marginal tax rate.

➤ **Proportional Tax**

A proportional tax is a tax imposed so that the tax rate is fixed, with no change as the taxable base amount increases or decreases. The amount of the tax is in proportion to the amount subject to taxation. As a result, such a flat marginal rate is consistent with a progressive average tax rate.

➤ **Foreign Direct Investment (FDI)**

Foreign direct investment (FDI) is an investment made by a company or individual in one country in business interests in another country, in the form of either establishing business operations or acquiring business assets in the other country, such as ownership or controlling interest in a foreign company. Foreign direct investments are distinguished from portfolio investments in which an investor merely purchases equities of foreign-based companies. The key feature of foreign direct investment is that it is an investment made that establishes either effective control of, or at least substantial influence over, the decision making of a foreign business.

➤ **Circular debt**

The circular debt is a situation in which a string of debtors and creditors exist in a fashion such that the net final creditor in the string is indebted to the first creditor. In a given industry or services sector owned by the State this definition applies in its entirety.

➤ **Devaluation of Currency and why it is done?**

Devaluation is a deliberate downward adjustment to the value of a country's currency relative to another currency, group of currencies or standard. Devaluation is a monetary policy tool used by countries that have a fixed exchange rate or semi-fixed exchange rate.

Why do countries devalue their currency?

- To Boost Exports
- To Shrink Trade Deficits
- To Reduce Sovereign Debt Burdens

➤ **Keynes Theory**

Keynesian economics states that in the short-run, economic output is substantially influenced by aggregate demand.

- Keynesian theory was first introduced by British economist John Maynard Keynes in his book *The General Theory of Employment, Interest, and Money*, which was published in 1936 during the Great Depression.

- Keynesian theorists believe that aggregate demand is influenced by a series of factors and responds unexpectedly. Shifts in aggregate demand impact production, employment, and inflation in the economy.
- Unemployment is the result of structural inadequacies within the economic system. It is not a product of laziness as believed previously.
- During a recession the economy may not return naturally to full employment. The government must step in and utilize government spending to stimulate economic growth. A lack of investment in goods and services causes the economy to operate below its potential output and growth rate.
- Overcoming an economic depression required economic stimulus, which could be achieved by cutting interest rates and increasing the level of government investment.

➤ **Import**

An import is a good or service brought into one country from another. The word "import" is derived from the word "port," since goods are often shipped via boat to foreign countries. Along with exports, imports form the backbone of international trade; the higher the value of imports entering a country, compared to the value of exports, the more negative that country's balance of trade becomes.

➤ **Export**

An export is a function of international trade whereby goods produced in one country are shipped to another country for future sale or trade. The sale of such goods adds to the producing nation's gross output. If used for trade, exports are exchanged for other products or services in other countries.

➤ **Anti-Dumping Duty**

An anti-dumping duty is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below fair market value. **Dumping** is a process where a company exports a product at a price lower than the price it normally charges on its own home market. To protect local businesses and markets, many countries impose stiff duties on products they believe are being dumped in their national market.

➤ **Import Substitution**

Government strategy that emphasizes replacement of some agricultural or industrial imports to encourage local production for local consumption, rather than producing for export markets. Import substitutes are meant to generate employment, reduce foreign exchange demand, stimulate innovation, and make the country self-reliant in critical areas such as food, defense, and advanced technology.

➤ **Infant industry**

An infant industry is a new industry, which in its early stages experiences relative difficulty or is absolutely incapable in competing with established competitors abroad.

➤ **Growth Theory**

The classical growth theory is the theory on economic growth that argues that economic growth will end because of an increasing population and limited resources. Classical Growth Theory economists believed that temporary increases in real GDP per person would cause a population explosion that would consequently decrease real GDP.

Neoclassical growth theory is an economic theory that outlines how a steady economic growth rate can be accomplished with the proper amounts of the three driving forces: labor, capital and technology. The theory states that by varying the amounts of labor and capital in the production function, an equilibrium state can be accomplished. The theory also argues that technological change has a major influence on an economy, and that economic growth cannot continue without advances in technology. **The new growth theory** is an economic growth theory that posits humans' desires and unlimited wants foster ever-increasing productivity and economic growth. The new growth theory argues that real GDP per person will perpetually increase because of people's pursuit of profits. As competition lowers the profit in one area, people have to constantly seek better ways to do things or invent new products in order to garner a higher profit. This main idea is one of the central tenets of the theory.

➤ **Dependency Theory**

Dependency theory became popular in the 1960's as a response to research by *Raul Prebisch*. Prebisch found that increases in the wealth of the richer nations appeared to be at the expense of the poorer ones. In its extreme form, dependency theory is based on a Marxist view of the world, which sees globalization in terms of the spread of market capitalism, and the exploitation of cheap labor and resources in return for the obsolete technologies of the West. The dominant view of dependency theorists is that there is a dominant world capitalist system that relies on a division of labor between the rich 'core' countries and poor 'peripheral' countries. Over time, the core countries will exploit their dominance over an increasingly marginalized periphery.

Dependency theory advocated an *inward looking* approach to development and an increased role for the state in terms of imposing barriers to trade, making inward investment difficult and promoting nationalization of key industries.

Although still a popular theory in history and sociology, dependency theory has disappeared from the mainstream of economic theory since the collapse of Communism in the early 1990s. The considerable inefficiencies associated with state involvement in the economy and the growth of corruption, have been dramatically exposed in countries that have followed this view of development, most notably a small number of African economies, including Zimbabwe.

➤ **Steps to increase exports**

Increasing exports ranks among the highest priorities of any government wishing to stimulate economic growth. There is, however, still strong disagreement on how governments should intervene. For instance, it has often been argued that the best governments can do is to eliminate the obstacles to the smooth functioning of market forces and provide information to exporting firms about destination markets and foreign competitors. This view is, of course, far from being unanimously shared. While policymakers continue to debate the issue, our survey of the literature on successful strategies and practices for boosting export has enabled us to compile a list of best practices (Belloc and Di Maio 2011):

Creation of duty drawback schemes. Among the traditional measures, the duty drawback scheme is, as surveys of entrepreneurs' opinions suggest, one measure that has proven to be successful in the past. Standard duty drawback schemes can be improved by: (a) making them accessible also to indirect exporters and extending them to imported inputs used in production of exported final products; (b) eliminating duty pre-payment for exporting firms in order to reduce credit requirements.

Increasing the availability of credit. The availability of short and (especially) long-term credit is crucial to exporters. This is decisive for small and medium enterprises (SMEs), for which the credit constraints are more binding than for large firms. Since SMEs make up the large majority of firms in developing countries, improvements in this domain are necessary to favour export growth.

Simplifying regulation. The government should simplify regulation related to exports; long bureaucracy procedures negatively affect especially new exporters. At the same time, governments should improve information collection and dissemination about foreign markets and requirements for exporting. Actions in this category should also consider product standards and other technical requirements imposed for exporting to developed country markets.

Improving cooperation among economic factors. Besides traditional policy instruments, export growth could be favoured by improving cooperation among exporters and between the government and business actors. For instance, there is nowadays increasing awareness about the possibility of using export consortia to help SMEs access the international markets. This may be seen as a complement to other forms of government intervention.

Combining short-term and long-term export growth policies. The stimulation of export growth requires the combination of short- and long-term policies. In this context, it is important to also exploit the complementarity between EPPs and other domestic policies (aimed, for instance, at enhancing productivity and technological content of domestic products).

Strategic collaboration between different levels of government (sub-national and national level, for instance) and the private sector is widely considered a key element for policy success.

Indeed, a pre-condition for successful EPPs is the domestic government ability, including policy design, implementation, enforcement and monitoring. It follows that the policy mix suggested for a given country must be tailored on the basis of capabilities available to national government, sub-national government and the domestic agencies. In the extreme case, this argument could lead to very practical criteria for policy design, suggesting the (second) best policy mix relying on considerations about the most efficient (least corrupted) governmental institutions. Adopting such criteria could minimize resource waste and reduce the danger of fostering powerful domestic interest groups and rent-seeking activities.

The careful analysis of the specificities of the local economic and institutional environment suggests not to borrow policy strategies from other countries simply because they have been successful there. Indeed, the same policy (or policy mix) implemented in two different countries may yield completely different outcomes. In particular, the country specific institutional environment is crucial for policy results.

Institutional and policy complementarities are important. Domestic policies may affect export performance either directly, through the set of policy instruments with direct influence on foreign trade, or indirectly, through the set of policy measures that have their direct influence on other aspects of the economic systems (for instance, monetary and fiscal policies, production and price controls, investment policies, exchange rate policies) and, in turn, stimulate foreign trade performance. All these policy measures cannot be considered in isolation; not only does the choice of policy matter, but also the economic and institutional context and policy mix within which it is implemented.

In conclusion, our review of the literature finds that successful export promotion policies have clearly defined priorities, goals, and objectives. In particular, they:

- Enhance the domestic enabling environment for potential exporters (in terms of infrastructures, regulation, access to finance, insurance, fiscal policies);
- Foster the strategic cooperation between private and public actors and among domestic producers, exporters, and policymakers;
- Improve the productivity and technological content of domestic goods, and provide incentives to nurturing innovation;
- Facilitate the access to credit,
- Serve to build the country image in foreign markets (through marketing, information provision, advocacy);
- Offer targeted and tailored assistance, and rely on continuous evaluation;
- Are supported by monetary and fiscal policies designed to improve the enabling environment; and
- Stimulate institutional development, also considering institutional complementarities.

➤ **Main Sources of Income for the Government**

Government revenue is money received by a government. It is an important tool of the fiscal policy of the government and is the opposite factor of government spending. Revenues earned by the government are received from sources such as taxes levied on the incomes and wealth accumulation of individuals and corporations and on the goods and services produced, exports and imports, non-taxable sources such as government-owned corporations' incomes, central bank revenue and capital receipts in the form of external loans and debts from international financial institutions. It is used to benefit the country. Governments use revenue to better develop the country it is used to fix roads, build homes, fix school etc. The money that government collects to pay for the services that is provided for the people. The sources of finance used by the central government are mainly taxes paid by the public

➤ **Main Expenditure of the Government**

Government expenditures are used either to purchase a portion of gross domestic product (government purchases) or as gifts to members of the other sectors (transfer payments). Both types of expenditures have an impact on the macro economy. They can trigger business-cycle instability or be used to address the unemployment and inflation problems of this instability.

Government Functions

The government sector undertakes expenditures to carry out specific functions. Some of the key functions are:

- **Common Defense:** The defense of the country is a long-standing government function that involves the purchase of military equipment and the services of military personnel.
- **Education:** Educating members of society is provided through public schools, higher education, and assorted job training programs that require an assortment of expenditures, especially teacher salaries.
- **Transportation:** Transportation systems, including urban streets, interstate highways, subways, buses, railroads, and air transit, are either provided directly by the government sector or indirectly by the private sector with government assistance.
- **Public Health and Safety:** Governments also devote resources and expenditures to public health and safety, including fire protection, police protection, disease control, and environmental quality.
- **Legal and Judicial System:** A legal and judicial system that establishes the "rules of the game" is critical to the efficient operation of an economy, which also requires payments for lawmaker and judicial salaries, as well as assorted related expenses.

Purchases and Transfers

Government expenditures generally fall into one of two broad categories--purchases or transfer payments.

- **Purchases:** The government sector annually purchases about 10 to 15 percent of the final goods and services produced by the economy, what is termed gross domestic product. This production is used by the government sector to pursue its assorted functions. That is, the government sector buys fighter jets to provide for the common defense or pays the salary of a health inspector to prevent the spread of disease.
- **Transfers:** The government sector also devotes a portion of its expenditures to transfer payments. Transfer payments are basically gifts, payments that are made without any expectations of production. Common transfer payments include those made to members of the household sector for welfare, Social Security, or unemployment support.

Taxes and Borrowing

The government sector finances expenditures in a combination of two ways--taxes and borrowing.

- **Taxes:** Taxes are involuntary payments to the government sector. Taxes are commonly placed on specific items or activities, including income, retail sales, and property. Fees or user charges, which are payments to the government sector for the purchase of specific goods or services (such as a drivers license), are also included in the general category of tax revenue. The bulk of the revenue used by the government sector for spending comes from taxes.
- **Borrowing:** When the government sector has more spending than tax revenue, it makes up the difference through borrowing, that is, by selling legal claims through the financial markets. This borrowing, like taxes, ultimately comes from household sector income. However, in this case, the government sector must eventually repay the loans, which it does with future tax revenue.

➤ **Measures for Economic Performance**

- Economic growth – real GDP growth.
- Inflation – e.g. target CPI inflation of 2%
- Unemployment – target of full employment
- Current account – satisfactory current account, e.g. low deficit.

➤ **Constraints**

Element, factor, or subsystem that works as a bottleneck. It restricts an entity, project, or system (such as a manufacturing or decision making process) from achieving its potential (or higher level of output) with reference to its goal.

➤ **Industry Practice Constraint**

The industry practices constraint, also called the industry practices concept, states that the nature of certain industries and their practices can require the departure of traditional accounting theory. In other words, some industries have practices unlike any other that require specialized accounting or reporting. The industry practices constraint allows these industries to go outside of traditional accounting principles as long as it is infrequent and justifiable

➤ **Organization to facilitate International Trade**

World Trade Organization (WTO)

➤ **WTO**

History and operations of W.T.O

World Trade Organization (WTO) is the successor to General Agreement on Tariffs and Trade (GATT). According to the agreement reached in the Uruguay Round, GATT was converted into a formal international organization called World Trade Organization. WTO came into operation on 1st January 1995. Now, WTO serves as an international framework for world trade. It is being directed by a Ministerial conference which will meet at least once every two years. Its normal business operations will be overseen by General council.

Objectives of W.T.O

Based in Geneva, Switzerland, WTO serves the following objectives:

1. **Enhancing the standard of living** and income, promoting full employment, expanding production, trade and optimum utilization of world's resources.
- 2 **Introducing sustainable development**, a concept which envisages that development and environment can go together.
3. **Taking positive steps** to ensure that developing countries, especially the least developed ones, secure a better share in world trade.

Functions of W.T.O

World Trade Organization is a powerful body with enlarged functions. It is envisaged to play a crucial role in the world's economic affairs.

The essential functions of W.T.O are as follows:

1. Administering and **implementing the multilateral and plurilateral trade agreements**. Providing the framework for the implementation, administration and operation of plurilateral trade agreements.
2. **To provide symposium for dialogues** among members nations regarding multilateral trade relations in matters delineated in the agreements.
3. **Administering the understanding** on rules and procedures governing the settlement of disputes.
4. Seeking to **resolve trade disputes**.
5. **Overseeing national trade policies**.
6. Administering the **trade review-mechanism** in relation to international trade.
7. **Cooperating with international institutions** such as IMF and IBRD and its affiliated agencies involved in global policy making.

Functions of W.T.O's General Council

The regular business of WTO is over seen by a General council. The General Council performs the following functions:

1. Supervising the functioning of revised agreements, operations of the revised agreements and ministerial declarations related to goods and services, trade related aspects of intellectual property rights (TRIPs) on regular basis.
2. Acting as a dispute settlement body.
3. Serving as a trade review mechanism; and
4. Establishing Goods councils, services councils and TRIPs councils as subsidiary bodies.

➤ **Profit Maximization**

Profits are maximized when marginal revenue = marginal cost

Total profit is maximized at an output level when **marginal revenue = marginal cost**

A process that companies undergo to determine the best output and price levels in order to maximize its return. The company will usually adjust influential factors such as production costs, sale prices, and output levels as a way of reaching its profit goal. There are two main profit maximization methods used, and they are Marginal Cost-Marginal Revenue Method and Total Cost-Total Revenue Method. Profit maximization is a good thing for a company, but can be a bad thing for consumers if the company starts to use cheaper products or decides to raise prices.

➤ **Finance**

Finance describes the management, creation and study of money, banking, credit, investments, assets and liabilities that make up financial systems, as well as the study of those financial instruments.

These are types of finance:

Public finance includes tax systems, government expenditures, budget procedures, stabilization instruments, debt issues and other government concerns.

Corporate finance involves managing assets and debt for a business.

Personal finance includes proper management of an individual's income and expenses so enough money is left over for savings.

Sources of Finance

They are classified based on time period, ownership and control, and their source of generation.

ACCORDING TO TIME-PERIOD:

LONG TERM SOURCES OF FINANCE: Long-term financing means capital requirements for a period of more than 5 years to 10, 15, 20 years or maybe more depending on other factors.

Share Capital or Equity Shares

Preference Capital or Preference

Shares Retained Earnings or Internal

Accruals Debenture / Bonds

MEDIUM TERM SOURCES OF FINANCE: period of 3 to 5 years Preference Capital or Preference Shares

Debenture / Bonds

Medium Term Loans

from Financial Institutes

Government, and

Commercial Banks

Lease Finance

Hire Purchase Finance

SHORT TERM SOURCES OF FINANCE: for a period of less than 1 year

Need for short term finance arises to finance the current assets of a business like an inventory of raw material and finished goods, debtors, minimum cash and bank balance etc.

Short term finances are available in the form of:

Trade Credit

Short Term Loans like Working Capital Loans from Commercial Banks

Fixed Deposits for a period of 1 year or less

Advances received from customers

Creditors

Payables Factoring

Services Bill

Discounting etc.

ACCORDING TO OWNERSHIP AND CONTROL:

OWNED CAPITAL

Whenever we bring in capital, there are two types of costs – one is interest and another is sharing of ownership and control.

Owner's capital is sourced from following sources:

Equity Capital

Preference Capital

Retained Earnings Convertible

Debentures Venture Fund or

Private Equity

BORROWED CAPITAL:

Borrowed capital is the capital arranged from outside sources. These include the following: Financial institutions,

Commercial banks or

The general public in case of debentures.

ACCORDING TO SOURCE OF GENERATION:

INTERNAL SOURCES

Internal source of capital is the capital which is generated internally from the business. Internal sources are as follows:

Retained profits

Reduction or controlling of working capital

Sale of assets etc.

EXTERNAL SOURCES

An external source of finance is the capital which is generated from outside the business. Apart from the internal sources finance, all the sources are external sources of capital

➤ **Finance Theories**

Numerous economists have explained the role of finance in the market with the help of different finance theories. The concept of finance theory involves studying the various ways by which businesses and individuals raise money, as well as how money is allocated to projects while considering the risk factors associated with them.

The concept of finance also includes the study of money and other assets, managing and profiling project risks, control and management of assets, and the science of managing money. In simple terms, financing also means provision and allocation of funds for a particular business module or project.

There are a number of finance theories that offer separate approaches to the finance hypotheses. Some of the major popular finance theories of the world are:

- Arbitrage Pricing Theory
- Rational Choice Theory
- Prospect Theory
- Cumulative Prospect Theory
- Monte Carlo Option Model
- Binomial Options Pricing Model
- Gordon Model
- International Fisher Effect
- Black Model
- Legal Origins Theory

➤ **Financial markets and its types**

A financial market is a market in which people trade financial securities, commodities, and other fungible items of value at low transaction costs and at prices that reflect supply and demand. Securities include stocks and bonds, and commodities include precious metals or agricultural products. A financial market is a broad term describing any marketplace where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives. Financial markets are typically defined by having transparent pricing, basic regulations on trading, costs and fees, and market forces determining the prices of securities that trade.

Financial markets can be found in nearly every nation in the world. Some are very small, with only a few participants, while others - like the New York Stock Exchange (NYSE) and the forex markets - trade trillions of dollars daily.

Investors have access to a large number of financial markets and exchanges representing a vast array of financial products. Some of these markets have always been open to private investors; others remained the exclusive domain of major international banks and financial professionals until the very end of the twentieth century.

Capital Markets

A capital market is one in which individuals and institutions trade financial securities. Organizations and institutions in the public and private sectors also often sell securities on the capital markets in order to raise funds. Thus, this type of market is composed of both the primary and secondary markets.

Any government or corporation requires capital (funds) to finance its operations and to engage in its own long-term investments. To do this, a company raises money through the sale of securities - stocks and bonds in the company's name. These are bought and sold in the capital markets.

Stock Markets

Stock markets allow investors to buy and sell shares in publicly traded companies. They are one of the most vital areas of a market economy as they provide companies with access to capital and investors with a slice of ownership in the company and the potential of gains based on the company's future performance.

This market can be split into two main sections: the primary market and the secondary market.

The primary market is where new issues are first offered, with any subsequent trading going on in the secondary market.

Bond Markets

A bond is a debt investment in which an investor loans money to an entity (corporate or governmental), which borrows the funds for a defined period of time at a fixed interest rate. Bonds are used by companies, municipalities, states and U.S. and foreign governments to finance a variety of projects and activities. Bonds can be bought and sold by investors on credit markets around the world. This market is alternatively referred to as the debt, credit or fixed-income market. It is much larger in nominal terms than the world's stock markets. The main categories of bonds are corporate bonds, municipal bonds, and U.S. Treasury bonds, notes and bills, which are collectively referred to as simply "Treasuries." (For more, see the *Bond Basics Tutorial*.)

Money Market

The money market is a segment of the financial market in which financial instruments with high liquidity and very short maturities are traded. The money market is used by participants as a means for borrowing and lending in the short term, from several days to just under a year. Money market securities consist of negotiable certificates of deposit (CDs), banker's acceptances, U.S. Treasury bills, commercial paper, municipal notes, Eurodollars, federal funds and repurchase agreements (repos). Money market investments are also called cash investments because of their short maturities.

The money market is used by a wide array of participants, from a company raising money by selling commercial paper into the market to an investor purchasing CDs as a safe place to park money in the short term. The money market is typically seen as a safe place to put money due the highly liquid nature of the securities and short maturities. Because they are extremely conservative, money market securities offer significantly lower returns than most other securities. However, there are risks in the money market that any investor needs to be aware of, including the risk of default on securities such as commercial paper. (To learn more, read our *Money Market Tutorial*.)

Cash or Spot Market

Investing in the cash or "spot" market is highly sophisticated, with opportunities for both big losses and big gains. In the cash market, goods are sold for cash and are delivered immediately. By the same token, contracts bought and sold on the spot market are immediately effective. Prices are settled in cash "on the spot" at current market prices. This is notably different from other markets, in which trades are

determined at forward prices.

The cash market is complex and delicate, and generally not suitable for inexperienced traders. The cash markets tend to be dominated by so-called institutional market players such as hedge funds, limited partnerships and corporate investors. The very nature of the products traded requires access to far-reaching, detailed information and a high level of macroeconomic analysis and trading skills.

Derivatives Markets

The derivative is named so for a reason: its value is derived from its underlying asset or assets. A derivative is a contract, but in this case the contract price is determined by the market price of the core asset. If that sounds complicated, it's because it is. The derivatives market adds yet another layer of complexity and is therefore not ideal for inexperienced traders looking to speculate. However, it can be used quite effectively as part of a risk management program. (To get to know derivatives, read *The Barnyard Basics of Derivatives*.)

Examples of common derivatives are forwards, futures, options, swaps and contracts-for-difference (CFDs). Not only are these instruments complex but so too are the strategies deployed by this market's participants. There are also many derivatives, structured products and collateralized obligations available, mainly in the over-the-counter (non-exchange) market that professional investors, institutions and hedge fund managers use to varying degrees but that play an insignificant role in private investing.

Forex and the Interbank Market

The interbank market is the financial system and trading of currencies among banks and financial institutions, excluding retail investors and smaller trading parties. While some interbank trading is performed by banks on behalf of large customers, most interbank trading takes place from the banks' own accounts.

The forex market is where currencies are traded. The forex market is the largest, most liquid market in the world with an average traded value that exceeds \$1.9 trillion per day and includes all of the currencies in the world. The forex is the largest market in the world in terms of the total cash value traded, and any person, firm or country may participate in this market.

There is no central marketplace for currency exchange; trade is conducted over the counter. The forex market is open 24 hours a day, five days a week and currencies are traded worldwide among the major financial centers of London, New York, Tokyo, Zürich, Frankfurt, Hong Kong, Singapore, Paris and Sydney.

Until recently, forex trading in the currency market had largely been the domain of large financial institutions, corporations, central banks, hedge funds and extremely wealthy individuals. The emergence of the internet has changed all of this, and now it is possible for average investors to buy and sell currencies easily with the click of a mouse through online brokerage accounts. (For further reading, see *The Foreign Exchange Interbank Market*.)

Primary Markets vs. Secondary Markets

A primary market issues new securities on an exchange. Companies, governments and other groups obtain financing through debt or equity based securities. Primary markets, also known as "new issue markets," are facilitated by underwriting groups, which consist of investment banks that will set a beginning price range for a given security and then oversee its sale directly to investors.

The primary markets are where investors have their first chance to participate in a new security issuance. The issuing company or group receives cash proceeds from the sale, which is then used to fund operations or expand the business. (For more on the primary market, see our *IPO Basics Tutorial*.)

The secondary market is where investors purchase securities or assets from other investors, rather than from issuing companies themselves. The Securities and Exchange Commission (SEC) registers securities prior to their primary issuance, then they start trading in the secondary market on the New York Stock Exchange, Nasdaq or other venue where the securities have been accepted for listing and trading. (To learn more about the primary and secondary market, read *Markets Demystified*.)

The secondary market is where the bulk of exchange trading occurs each day. Primary markets can see increased volatility over secondary markets because it is difficult to accurately gauge investor demand for a new security until several days of trading have occurred. In the primary market, prices are often set beforehand, whereas in the secondary market only basic forces like supply and demand determine the price of the security.

Secondary markets exist for other securities as well, such as when funds, investment banks or entities such as Fannie Mae purchase mortgages from issuing lenders. In any secondary market trade, the cash proceeds go to an investor rather than to the underlying company/entity directly. (To learn more about primary and secondary markets, read *A Look at Primary and Secondary Markets*.)

The OTC Market

The over-the-counter (OTC) market is a type of secondary market also referred to as a dealer market. The term "over-the-counter" refers to stocks that are not trading on a stock exchange such as the Nasdaq, NYSE or American Stock Exchange (AMEX). This generally means that the stock trades either on the over-the-counter bulletin board (OTCBB) or the pink sheets. Neither of these networks is an exchange; in fact, they describe themselves as providers of pricing information for securities. OTCBB and pink sheet companies have far fewer regulations to comply with than those that trade shares on a stock exchange. Most securities that trade this way are penny stocks or are from very small companies.

Third and Fourth Markets

You might also hear the terms "third" and "fourth markets." These don't concern individual investors because they involve significant volumes of shares to be transacted per trade. These markets deal with transactions between broker-dealers and large institutions through over-the-counter electronic networks. The third market comprises OTC transactions between broker-dealers and large institutions. The fourth market is made up of transactions that take place between large institutions. The main reason these third and fourth market transactions occur is to avoid placing these orders through the main exchange, which could greatly affect the price of the security. Because access to the third and fourth markets is limited, their activities have little effect on the average investor.

Financial institutions and financial markets help firms raise money. They can do this by taking out a loan from a bank and repaying it with interest, issuing bonds to borrow money from investors that will be repaid at a fixed interest rate, or offering investors partial ownership in the company and a claim on its residual cash flows in the form of stock.

➤ **Future option**

Futures are financial contracts obligating the buyer to purchase an asset or the seller to sell an asset, such as a physical commodity or a financial instrument, at a predetermined future date and price. Futures contracts detail the quality and quantity of the underlying asset; they are standardized to facilitate trading on a futures exchange. Some futures contracts may call for physical delivery of the asset, while others are settled in cash.

➤ **Forward Contract**

A forward contract is a financial agreement in which the buyer agrees to pay the seller a predetermined price for a specified quantity of a commodity to be delivered at some point in the future.

Forward contracts allow buyers and sellers to know in advance the price as well as the date in which they will take or make delivery of the goods. This knowledge enables them to plan ahead and ultimately they can save expenses - cutting down storage costs for instance.

Forward contracts are privately negotiated, bilateral agreements and the terms of each contract are non-standardized. They are over-the-counter derivatives closely related to futures contracts but they differ in certain aspects.

➤ **Money bill**

a money bill or supply bill is a bill that solely concerns taxation or government spending (also known as appropriation of money), as opposed to changes in public law.

➤ **World Bank Report Overview on Pakistan**

Pakistan has made significant progress in regaining macroeconomic stability over the past three years. Pakistan has achieved macroeconomic stability in the past three years: the fiscal deficit has shrunk from 8 percent to below 5 percent, international reserves have tripled to over \$18b, and the rate of growth has increased by a full percentage point to 4.7 percent.

Economic indicators in the first half of FY17 suggest that pressures are mounting for both fiscal consolidation and external balances. The current account deficit will more than double in FY19 from 1.1 percent of GDP in FY16. Reserves are forecast to be around \$18b by FY19, still well above three months of imports. The fiscal deficit will widen from 4.5 percent of GDP in FY16 to 5.1 percent in FY18, and will decline slightly to 4.9 percent in FY19. Pakistan has also embarked on an ambitious structural reforms program. Implementation record has been mixed. There were early successes in taxation, the financial sector, the business environment (at both the national and provincial levels), and the electricity sector. However, significant reforms undertaken in the electricity sector have stalled since the Government stopped privatization a year ago.

Circular debt cleared earlier has piled up again nearly to its 2013 levels. There have been efforts to reduce the electricity regulator's independence. Progress in improving development outcomes have been mixed and investment levels remain very low, at around 15 percent of GDP (both public and private). Maintaining macroeconomic stability and further progress in structural reforms will be necessary to accelerate growth and ensure it is inclusive and sustainable.

Growth, though volatile and low in some periods, has been quite pro-poor in Pakistan over the past decade and a half. The headcount poverty rate has fallen consistently over this period, from 34.7 percent in FY01/02 to 9.3 percent in FY13/14 (using the latest survey data and the old poverty line). Using incidence curves that plot the growth rate in consumption at each percentile of the distribution, it is evident that growth has been pro-poor in Pakistan through much of this period. Looking at the bottom 40 percent of the population—a measure of shared prosperity—we see a similar pattern. The Government adopted a revised methodology to measure poverty and a new poverty line in 2016. Under the revised poverty line, the poverty head count has declined from 64.3 percent in FY01/02 to 29.5 percent in FY13/14. Our understanding of what has caused this significant decline in poverty remains incomplete. Important contributors are higher GDP growth in the earlier years, strong growth in remittances, effective social assistance programs as well as rapid and ‘hidden’ urbanization which has led to a very vibrant informal sector.

Pakistan remains one of the lowest performers in the South Asia Region on human development indicators, especially in education and stunting. The Net Enrollment Rates in education have been increasing in Pakistan but still lag behind other South Asia countries. Infant and under five mortality rates represent a similar story. Gender disparities persist in education, health and all economic sectors. Pakistan has one of the lowest female labor force participation rates in the region. Nutrition also remains a significant cross-cutting challenge, as 44% of children under five are stunted. The spending on health, nutrition, and education, now totaling 3 percent of GDP, significantly lower than most other countries. Increased allocation will only be possible after increasing government revenues. The tax-to-GDP ratio, at 12.4 percent, is one of the lowest in the world and it is still half of what it could be for Pakistan. Continued reforms to broaden the tax base and increase revenues will therefore need to remain a priority. Service delivery is the responsibility of subnational governments, whose capacity varies, but the federal Government needs to play an assertive stewardship role as increased financing has to be accompanied by meaningful improvements in quality of services. A strategy to greatly improve development outcomes would therefore need to combine efforts to increase the level of public spending as well as improving its quality, with a focus on provincial level capacity.

Over the past couple of years, greater decision-making authority has been assigned to provincial governments. The Eighteenth Constitutional Amendment has devolved a number of key functions to the provinces. In total, functions in 17 federal ministries have been devolved, including Agriculture, Education, Environment, and Health. In addition, a greater share of revenues has been passed to the provinces through the National Finance Commission Award (NFC) in order to enable them to perform these functions. As expected, the devolution has posed institutional and capacity challenges at the provincial level, and meeting these challenges will require concerted efforts to enhance sub-national capacity and institutional development, which varies across provinces.

Population	188.9 million	2015
GDP	\$271.0 billion	2015
GDP Growth	4.7%	2015
Inflation	3.8%	2016

➤ **Conflict of Interest**

A conflict of interest is a situation in which a corporation or person with a vested interest in a company becomes unreliable because of the clash between personal interests and professional interests. An example of a conflict of interest would be a board member voting on the induction of lower premiums for companies with fleet vehicles when he is the owner of a truck company outside of the corporation. In relation to law, representation by a lawyer or party with a vested interest in the outcome of the trial would be considered a conflict of interest, and the representation would not be allowed

➤ **Wealth Maximization**

Wealth maximization is a modern approach to financial management. Maximization of profit used to be the main aim of a business and financial management till the concept of wealth maximization came into being. It is a superior goal compared to profit maximization as it takes broader arena into consideration.

➤ **Security Market Line**

Security market line (SML) is the representation of the capital asset pricing model. It displays the expected rate of return of an individual security as a function of systematic, non-diversifiable risk.

➤ **Capital Market Line**

Capital market line (CML) is the tangent line drawn from the point of the risk-free asset to the feasible region for risky assets.

➤ **Portfolio**

A collection of investments all owned by the same individual or organization. These investments often include stocks, which are investments in individual businesses; bonds, which are investments in debt that are designed to earn interest; and mutual funds, which are essentially pools of money from many investors that are invested by professionals or according to indices.

➤ **Stock exchange**

The stock market refers to the collection of markets and exchange where the issuing and trading of equities (stocks of publicly held companies), bonds and other sorts of securities takes place, either through formal exchanges or over-the-counter markets. Also known as the equity market, the stock market is one of the most vital components of a free-market economy, as it provides companies with access to capital in exchange for giving investors a slice of ownership.

➤ **Over-The-Counter Market**

A decentralized market, without a central physical location, where market participants trade with one another through various communication modes such as the telephone, email and proprietary electronic trading systems.

➤ **Difference between Current Account and Capital Account**

Current Account is the record of the inflow and outflow of money to and from the country during a year, due to the trading of commodity, service and income:

The Balance of Trade (only visible items i.e. goods): Goods imported and exported to and from the country.

Trading of Services: Services received from other countries and rendered to other nations.

Net investment income: Income from foreign investment less payments on foreign investments.

Net cash transfers: Current transfers in the form of donations, gifts, aids, etc. form part of net cash transfer.

Capital account records the movement of capital in the economy due to capital receipts and expenditure. It recognizes foreign investment in domestic assets and domestic investment in foreign assets.

The following are the components of Capital Account:

Foreign Direct Investment: Investment and control in a company based in a country by a foreign company.

Portfolio Investment: Investment in stocks, bonds, debts and other financial assets.

Government loans to the Government of other countries of the world.

Current account records the trading in goods and services in the current period. Capital Account records the movement of capital in and out the economy.

Current Account shows the net income of the country, whereas Capital Account shows the change in the ownership of the nation's assets.

➤ **Bubble economy**

An economy market in which prices for goods and services rise far above actual values. This trend continues until investors realize just how far prices have risen, usually but not always resulting in a sharp decline. Bubbles usually occur when investors, for any number of reasons, believe that demand in the economy will continue to rise far beyond what is sustainable. This results in the increased prices.

➤ **Reflation**

A fiscal or monetary policy, designed to expand a country's output and curb the effects of deflation.

Reflation policies can include reducing taxes, changing the money supply and lowering interest rates. The term "reflation" is also used to describe the first phase of economic recovery after a period of contraction.

➤ **Plutonomy**

Economic growth that is powered and consumed by the wealthiest upper class of society. Plutonomy refers to a society where the majority of the wealth is controlled by an ever-shrinking minority; as such, the economic growth of that society becomes dependent on the fortunes of that same wealthy minority.

➤ **Business Economics**

Business economics is the study of the financial issues and challenges faced by corporations operating in a specified marketplace or economy. Business economics deals with issues such as business organization, management, expansion and strategy.

Statistics

- **What is statistics**

The practice or science of collecting and analyzing numerical data in large quantities, especially for the purpose of inferring proportions in a whole from those in a representative sample.
- **What is data?**

Facts or figures from which conclusions can be drawn
- **Quantitative Data**

Quantitative data is data expressing a certain quantity, amount or range. Usually, there are measurement units associated with the data, e.g. meters, in the case of the height of a person. It makes sense to set boundary limits to such data, and it is also meaningful to apply arithmetic operations to the data.
- **Qualitative Data**

Qualitative data is a categorical measurement expressed not in terms of numbers, but rather by means of a natural language description. In statistics, it is often used interchangeably with "categorical" data. For example: favorite color = "blue" height = "tall" i hated the most = "loryel"
- **Uses of Statistics in Economy**

Various concepts of economic theory, such as functional relationship among variables are usually stated in terms of algebra, symbols, calculus and so on. To analyze various social and economic phenomena, economic theory can be better studied and analyzed in terms of 'appropriate' numbers. Such numbers, that is, statistics presents facts on the basis of a mass of figures. It helps comparison of facts. It establishes relationship between variables like price and quantity demanded or quantity supplied, global warming and agricultural output, money supply and price level and so on. Thus, economics as a discipline is linked up with statistics on many occasions. Today, we see that economic growth in India is hampered by faulty policies and better economic policymaking largely depends on the availability of improved data or statistics. Businessmen also find statistics as an indispensable tool in their regular activities.

The study of modern economics requires mathematical and statistical foundation. With the development of mathematics and statistics over the passage of time, econometric methods have been developed. We thus see wide applications of statistics in various fields.
- **Population**

All elements, individuals, or units that meet the selection criteria for a group to be studied, and from which a representative sample is taken for detailed examination. The total of all populations is called a universe.
- **Heterogeneity**

Heterogeneity in statistics means that your populations, samples or results are different. It is the opposite of homogeneity, which means that the population/data/results are the same.

A heterogeneous population or sample is one where every member has the same characteristic you're interested in. For example, if everyone in your group were 6' tall, they would be heterogeneous for height. In real life, heterogeneous populations are extremely common. For example, patients are typically a very heterogeneous population as they differ with many factors including demographics, diagnostic test results, and medical histories.
- **Homogeneity**

A data set is homogeneous if it is made up of things (i.e. people, cells or traits) that are similar to each other. For example a data set made up of 20-year-old college students enrolled in Physics 101 is a homogeneous sample.
- **Sample**

Sampling is a process used in statistical analysis in which a predetermined number of observations are taken from a larger population. The methodology used to sample from a larger population depends on the type of analysis being performed, but may include simple random sampling or systematic sampling.
- **Forecasting**

Forecasting is the use of historic data to determine the direction of future trends. Businesses utilize forecasting to determine how to allocate their budgets or plan for anticipated expenses for an upcoming period of time. This is typically based on the projected demand for the goods and services they offer.

➤ **Probability**

A probability distribution is a table or an equation that links each outcome of statistical experiment with its probability of occurrence. Consider a simple experiment in which we flip a coin two times. An outcome of the experiment might be the number of heads that we see in two coin flips

➤ **What Statistics tools are?**

Some of the statistical are as follows:

1. Collection of data (Primary or secondary)
2. Editing
3. Classification and tabulation
4. Tools of presentation: Diagrams and Graphs (Of various types)
5. Measures of Central Tendency (Mean, Mode, Median, G.M, H.M)
6. Measures of dispersion (Q.D, M.D., S.D.)
7. Moments, Skewness and Kurtosis
8. Correlation and regression
9. Index numbers (Using various methods)
- 10 Time Series
11. Sampling (Using various methods)
12. Business Forecasting (Using Interpolation Extrapolation etc.)
13. Analysis of Variance
14. Many other methods.

➤ **Simple Sampling**

A simple random sample is a subset of a statistical population in which each member of the subset has an equal probability of being chosen. An example of simple random sample would be the names of 25 employees being chosen out of a hat from a company of 250 employees.

➤ **Random Sampling**

A sampling method in which all members of a group (population or universe) have an equal and independent chance of being selected.

➤ **Stratified sampling**

Stratified sampling refers to a type of sampling method. With stratified sampling, the researcher divides the population into separate groups, called strata. Then, a probability sample (often a simple random sample) is drawn from each group. Stratified sampling has several advantages over simple random sampling.

➤ **What is CCI**

The commodity channel index (CCI) is an oscillator originally introduced by Donald Lambert in 1980. Since its introduction, the indicator has grown in popularity and is now a very common tool for traders in identifying cyclical trends not only in commodities, but also equities and currencies.

➤ **Central Tendency**

In statistics, a central tendency (or measure of central tendency) is a central or typical value for a probability distribution. It may also be called a center or location of the distribution. The most common measures of central tendency are the arithmetic mean, the median and the mode.

Business, Business Law, Types of Business, SECP, Money, Banking & Finance

➤ **Business, Types and Forms of Business Organizations**

A business entity is an organization that uses economic resources or inputs to provide goods or services to customers in exchange for money or other goods and services.

Business organizations come in different types and different forms of ownership.

Types of Business

There are three major types of businesses:

1. Service Business

A service type of business provides intangible products (*products with no physical form*). Service type firms offer professional skills, expertise, advice, and other similar products.

Examples of service businesses are: schools, repair shops, hair salons, banks, accounting firms, and law firms.

2. Merchandising Business

This type of business buys products at wholesale price and sells the same at retail price. They are known as "buy and sell" businesses. They make profit by selling the products at prices higher than their purchase costs.

A merchandising business sells a product without changing its form. Examples are: grocery stores, convenience stores, distributors, and other resellers.

3. Manufacturing Business

Unlike a merchandising business, a manufacturing business buys products with the intention of using them as materials in making a new product. Thus, there is a transformation of the products purchased.

A manufacturing business combines *raw materials, labor, and factory overhead* in its production process. The manufactured goods will then be sold to customers.

Hybrid Business

Hybrid businesses are companies that may be classified in more than one type of business. A restaurant, for example, combines ingredients in making a fine meal (manufacturing), sells a cold bottle of wine (merchandising), and fills customer orders (service).

Nonetheless, these companies may be classified according to their major business interest. In that case, restaurants are more of the service type – they provide *dining services*.

Forms of Business Organization

These are the basic forms of business ownership:

1. Sole Proprietorship

A sole proprietorship is a business owned by only one person. It is easy to set-up and is the least costly among all forms of ownership.

The owner faces *unlimited liability*; meaning, the creditors of the business may go after the personal assets of the owner if the business cannot pay them.

The sole proprietorship form is usually adopted by small business entities.

2. Partnership

A partnership is a business owned by two or more persons who contribute resources into the entity. The partners divide the profits of the business among themselves.

In *general partnerships*, all partners have unlimited liability. In *limited partnerships*, creditors cannot go after the personal assets of the limited partners.

3. Corporation

A corporation is a business organization that has a separate legal personality from its owners.

Ownership in a stock corporation is represented by *shares of stock*.

The owners (stockholders) enjoy limited liability but have limited involvement in the company's operations. The *board of directors*, an elected group from the stockholders, controls the activities of the corporation.

In addition to those basic forms of business ownership, these are some other types of organizations that are common today:

Limited Liability Company

Limited liability companies (LLCs) in the USA, are hybrid forms of business that have characteristics of both a corporation and a partnership. An LLC is not incorporated; hence, it is not considered a corporation.

Nonetheless, the owners enjoy limited liability like in a corporation. An LLC may elect to be taxed as a sole proprietorship, a partnership, or a corporation.

Cooperative

A cooperative is a business organization owned by a group of individuals and is operated for their mutual benefit. The persons making up the group are called *members*. Cooperatives may be incorporated or unincorporated.

Some examples of cooperatives are: water and electricity (utility) cooperatives, cooperative banking, credit unions, and housing cooperatives.

➤ SECP

The Securities and Exchange Commission of Pakistan (SECP) is the financial regulatory agency in Pakistan whose objective is to develop a modern and efficient corporate sector and a capital market based on sound regulatory principles, in order to encourage investment and foster economic growth and prosperity in Pakistan

➤ Functions of SECP

Develop a;

- Modern and efficient corporate sector
- Capital market. Based on sound regulatory principles in order to
- Encourage INVESTMENT and
- Foster ECONOMIC GROWTH and PROSPERITY in Pakistan. The

regulatory functions of SECP fall under following four broad categories

- Registration and licensing
- Supervision (prudential and regulatory)
- Appellate bench
- Investor awareness and education
- Administration of professional like chartered accountants, cost accountants and corporate secretaries.

➤ Types of Companies

There are different types of company, which can be classified on the basis of formation, liability, ownership, domicile and control.

Types of Companies On The Basis Of Formation or Incorporation

Chartered Companies: Companies which are incorporated under special charter or proclamation issued by the head of state, are known as chartered companies. The Bank of England, the East India Company and Chartered Bank etc. are the examples of chartered companies.

Statutory Companies: Companies which are formed or incorporated by a special act of parliament, are known as statutory companies. The activities of such companies are governed by their respective acts and are not required to have any Memorandum or Articles of Association.

Registered Companies: Registered companies are those companies which are formed by registration under the Company Act. Registered companies may be divided into two categories.

Private Company: A company is said to be a private company which by its Memorandum of Association restricts the right of its members to transfer shares, limits the number of its members and does not invite the public to subscribe its shares or debentures.

Public Company: A company, which is not private, is known as public company. It needs minimum seven persons for its registration and maximum to the limit of its registered capital. There is no restriction on issue or transfer of its shares and this type of company can invite the public to purchase its shares and debentures.

Types of Companies On The Basis Of Liability

Registered companies are divided into two types, namely, companies having limited liability and companies having unlimited liability.

Companies Having Limited Liability

This liability can be limited in two ways:

Liability Limited by Shares: These are those companies in which the capital is divided into shares and liability of members (shareholders) is limited to the extent of face value of shares held by them. This is the most popular class of company.

Liability Limited by Guarantee: These are such companies where shareholders promise to pay a fixed amount to meet the liabilities of the company in the case of liquidation.

Companies Having Unlimited Liability

A company not having any limit on the liability of its members as in the case of a partnership or sole trading concern is an unlimited company. If such a company goes into liquidation, the members can be called upon to pay an unlimited amount even from their private properties to meet the claim of the creditors of the company.

Types of Companies On The Basis Of Ownership

Government Companies: A government company is a company in which at least 51% of the paid up capital has been subscribed by the government.

Non-government Companies: If the government does not subscribe a minimum 51% of the paid up capital, the company will be a non-government company.

Types of Companies On The Basis Of Domicile

National Companies

A company, which is registered in a country by restricting its area of operations within the national boundary of such country is known as a national company.

Foreign Companies

A foreign company is a company having business in a country, but not registered in that country.

Multinational Companies

Multinational companies have their presence and business in two or more countries. In other words, a company, which carries on business activities in more than one country, is known as multinational company.

Types of Companies On The Basis Of Control

Holding Companies

A holding company is a company, which holds all, or majority of the share capital in one or more companies so as to have a controlling interest in such companies.

Subsidiary Company

A company, which operates its business under the control of another company (i.e holding company), is known as a subsidiary company.

➤ **Sister Company**

A sister company is a company with close affiliations to another company with a separate name and personnel. Both companies are owned by the same parent and are considered subsidiaries of the larger company.

➤ **Joint Venture**

A joint venture (JV) is a business agreement in which the parties agree to develop, for a finite time, a new entity and new assets by contributing equity. They exercise control over the enterprise and consequently share revenues, expenses and assets.

➤ **Registration of Company**

What are the major forms required for registration of companies:

Filing of documents required for registration of a private limited company in Pakistan:

The following documents are required to be filed with the registrar concerned for registration of a private limited company in Pakistan:

- Copy of national identity card or passport, in case of foreigner, of each subscriber and witness to the memorandum and article of association.
- Memorandum and articles of association - Four printed copies of Memorandum and Articles of Association duly signed by each subscriber in the presence of one witness.
- Form 1 - Declaration of compliance with the pre-requisites for formation of the company.
- Registration/filing fee - A copy of the original paid Challan in the authorized branches of Habib Bank Limited or a Bank Draft/ Pay Order drawn in favor of the Securities and Exchange Commission of Pakistan of the prescribed amount.
- Authorization by sponsors - The authorization of sponsors in favor of a person to make good the deficiencies, if any, in memorandum and articles of association as may be pointed out by the registrar concerned and to collect the certificate of incorporation

What is the purpose of form A, form 29 and what are the information are added in these forms:

Form 29 Particulars of directors and officers, including the chief executive, managing agent

Form A- annual return of company having share capital

Procedure for Registration of a Company in Pakistan:

Following are the requirements for registration of a company in Pakistan:

- Step No. 1 for Registration of a Company in Pakistan

Availability of Name

The first step with regard to incorporation of a company is to seek availability of the proposed name for the company from the Registrar. For this purpose, an application is to be made and a fee of Rs.200 is required to be paid for seeking availability certificate.

- Step No. 2 for Registration of a Company in Pakistan

Filing of documents required for registration of a private limited company in Pakistan.

➤ **Memorandum of Association (MOA)**

Memorandum of Association (MOA) is the supreme public document which contains all those information that are required for the company at the time of incorporation.

➤ **Articles of Association (AOA)**

Articles of Association (AOA) is the secondary document, which defines the rules and regulations made by the company for its administration and day to day management.

- Memorandum of Association is a document that contains all the condition which are required for the registration of the company. Articles of Association is a document that contains the rules and regulation for the administration of the company.
- Memorandum of Association is obligatory to be registered with the ROC at the time of registration of Company. As opposed to Articles of Association, is not required to be filed with the registrar, although the company may file it voluntarily.
- Memorandum of association defines the relationship between company and external party. On the contrary, articles of association govern the relationship between the company and its members and also between the members themselves.

➤ **Dividend**

A dividend is a distribution of a portion of a company's earnings, decided by the board of directors, to a class of its shareholders. Dividends can be issued as cash payments, as shares of stock, or other property.

➤ **Zero Dividend Preferred Stock**

A preferred share that is not required to pay a dividend to its holder. The owner of a zero-dividend preferred share will earn income from capital appreciation and may receive a one-time payment at the end of the investment term. Also referred to as "capital shares".

➤ **Negative Payout Ratio**

Receiving dividends from stock you own is great, but you want to make sure the company can afford to keep them coming. Companies pay dividends from their earnings, or profits. The dividend payout ratio measures the percentage of profits a company pays as dividends. When a company generates negative earnings, or a net loss, and still pays a dividend, it has a negative payout ratio. A negative payout ratio of any size is typically a bad sign. It means the company had to use existing cash or raise additional money to pay the dividend

➤ **Dividend Policy**

There are basically 4 types of dividend policy. Let us discuss them on by one:

1.) Regular dividend policy: in this type of dividend policy the investors get dividend at usual rate. Here the investors are generally retired persons or weaker section of the society who want to get regular income. This type of dividend payment can be maintained only if the company has regular earning.

Merits of Regular dividend policy:

- It helps in creating confidence among the shareholders.
- It stabilizes the market value of shares.
- It helps in marinating the goodwill of the company.
- It helps in giving regular income to the shareholders.

2) Stable dividend policy: here the payment of certain sum of money is regularly paid to the shareholders. It is of three types:

a) Constant dividend per share: here reserve fund is created to pay fixed amount of dividend in the year when the earning of the company is not enough. It is suitable for the firms having stable earning.

b) Constant payout ratio: it means the payment of fixed percentage of earning as dividend every year.
c) Stable rupee dividend + extra dividend: it means the payment of low dividend per share constantly + extra dividend in the year when the company earns high profit.

Merits of stable dividend policy:

- It helps in creating confidence among the shareholders.
- It stabilizes the market value of shares.
- It helps in maintaining the goodwill of the company.
- It helps in giving regular income to the shareholders.

3) Irregular dividend: as the name suggests here the company does not pay regular dividend to the shareholders. The company uses this practice due to following reasons:

- Due to uncertain earning of the company.
- Due to lack of liquid resources.
- The company sometime afraid of giving regular dividend.
- Due to not so much successful business.

4) No dividend: the company may use this type of dividend policy due to requirement of funds for the growth of the company or for the working capital requirement.

➤ **Banking & Finance**

Banking finance definition gives us information about the definition of banking and the definition of finance. Banking refers to that process in which a bank which is a commercial or government institution offers financial services that include lending money, collection of deposits, issue of currencies and debit cards, and transaction processing etc.

The majority of banks works as profit-seeking enterprises, however, a few government banks work as non-profit organizations. Central banks function as government agencies and they regulate the interest rates and circulation of money in the total economy.

The activities of banks can usually be categorized into the following types :

Receiving deposits from the customers and issue of current or checking accounts and savings accounts to businesses and individuals

Providing financial consultation services to individuals and

businesses Providing loans to businesses and individuals

Encashment of checks

Facilitation of monetary transactions, for example cashier checks and wire transfers

Issue of ATM cards, credit cards, and debit cards

Offering safe deposit vaults for keeping

valuables Encashment and distribution of bank

rolls Retirement & pension planning

➤ **Time Value of Money**

The time value of money (TVM) is the idea that money available at the present time is worth more than the same amount in the future due to its potential earning capacity. This core principle of finance holds that, provided money can earn interest, any amount of money is worth more the sooner it is received.

➤ **Agreement**

When a person (promisor) offers something to someone else (promisee), and the concerned person accepts the proposal with equivalent consideration, this commitment is known as the agreement. When two or more than two persons agree upon the same thing in the same sense (i.e. Consensus ad idem), this identity of minds is agreement. The following are the types of agreement are as under:

- Wagering Agreement
- Void Agreement
- Voidable Agreement
- Implied Agreement
- Express Agreement
- Conditional Agreement
- Illegal Agreement.

➤ **Contract**

Contract is an agreement enforceable at law.

The contract may be oral or written. The major types of contract are as under:

- Void Contract
- Voidable Contract
- Valid Contract
- Unilateral Contract

- Bilateral Contract
- Express Contract
- Tacit Contract
- Contingent Contract
- Implied Contract
- Executed Contract
- Executory Contract
- Quasi Contract etc.

➤ **Essentials of valid contract**

1. Offer and acceptance.
2. Legal relationship.
3. Consensus-ad-idem.
4. Competency of parties.
5. Free consent.
6. Lawful consideration.
7. Lawful object.
8. Not declared to be void.
9. Certainty and possibility of performance.
10. Legal formalities.

➤ **Essentials of Acceptance of Contract**

1. Acceptance must be given by the person to whom the proposal is made
2. Acceptance can be given only when the acceptor has the knowledge of the offer
3. The acceptance must be absolute and unconditional
4. The acceptance must be given within the time prescribed or within a reasonable time
5. The acceptance must be given before the lapse of offer
6. The acceptance must be communicated
7. The acceptance must be communicated to the offer or himself
8. The acceptance must be in the prescribed manner
9. The acceptance must be given in some usual and reasonable manner
10. The acceptance must show an intention that acceptor is willing to fulfil the terms of the offer
11. The acceptance may be express or implied
12. The acceptance cannot be presumed from silence

➤ **Breach of contract**

Legally, one party's failure to fulfill any of its contractual obligations is known as a "breach" of the contract. Depending on the specifics, a breach can occur when a party fails to perform on time, does not perform in accordance with the terms of the agreement, or does not perform at all.

➤ **Bonus shares**

An issue of bonus shares is referred to as a bonus share issue or bonus issue. A bonus issue is usually based upon the number of shares that shareholders already own. While the issue of bonus shares increases the total number of shares issued and owned, it does not change the value of the company.

➤ **Shares and its types**

The capital of the company can be divided into different units with definite value called shares. Holders of these shares are called shareholders or members of the company. There are two types of shares which a company may issue (1) Preference Shares (2) Equality Shares.

(1) Preferences Shares

Shares which enjoy the preferential rights as to dividend and repayment of capital in the event of winding up of the company over the equity shares are called preference shares. The holder of preference shares will get a fixed rate of dividend.

Preference shares may be:

(a) Cumulative Preference Share

If the company does not earn adequate profit in any year, dividends on preference shares may not be paid for that year. But if the preference shares are cumulative such unpaid dividends on these shares go on accumulating and become payable out of the profits of the company, in subsequent years. Only after

such arrears have been paid off, any dividend can be paid to the holder of quality shares. Thus a cumulative preference shareholder is sure to receive dividend on his shares for all the years out of the earnings of the company.

(b) Non-cumulative Preference Shares

The holders of non-cumulative preference shares no doubt will get a preferential right in getting a fixed dividend it is distributed to quality shareholders. The fixed dividend is to be paid only out of the divisible profits but if in a particular year there is no profit as to distribute it among the shareholders, the non-cumulative preference shareholders, will not get any dividend for that year and they cannot claim it in the next year during which period there might be profits. If it is not paid, it cannot be carried forward. These shares will be treated on the same footing as other preference shareholders as regards payment of capital in concerned.

(c) Redeemable Preference Shares

Capital raised by issuing shares, is not to be repaid to the shareholders (except buy back of shares in certain conditions) but capital raised through the issue of redeemable preference shares is to be paid back by the raised thought the issue of redeemable preference shares is to be paid back to the company to such shareholders after the expiry of a stipulated period, whether the company is wound up or not. As per section (80) 5a, a company after the commencement of the Companies (Amendment) Act, 1988 cannot issue any preference shares which are irredeemable or redeemable after the expiry of a period of 10 years from the date of its issue. It means a company can issue redeemable preference share which are redeemable within 10 years from the date of their issue.

(d) Participating or Non-participating Preference Shares

The preference shares which are entitled to a share in the surplus profit of the company in addition to the fixed rate of preference dividend are known as participating preference shares. After the payment of the dividend a part of surplus is distributed as dividend among the quality shareholders at a particulate rate. The balance may be shared both by equity shareholders at a particular rate. The balance may be shared both by equity and participating preference shares. Thus participating preference shareholders obtain return on their capital in two forms (i) fixed dividend (ii) share in excess of profits. Those preference shares which do not carry the right of share in excess profits are known as non-participating preference shares.

(2) Equity Shares

Equity shares will get dividend and repayment of capital after meeting the claims of preference shareholders. There will be no fixed rate of dividend to be paid to the equity shareholders and this rate may vary from year to year. This rate of dividend is determined by directors and in case of larger profits, it may even be more than the rate attached to preference shares. Such shareholders may go without any dividend if no profit is made.

➤ **Consumer banking**

Retail banking, also known as consumer banking, is the provision of services by a bank to individual consumers, rather than to companies, corporations or other banks. Services offered include savings and transactional accounts, mortgages, personal loans, debit cards, and credit cards.

➤ **Fixed Exchange Rate**

A fixed exchange rate denotes a nominal exchange rate that is set firmly by the monetary authority with respect to a foreign currency or a basket of foreign currencies.

➤ **Floating Exchange Rate**

A floating exchange rate is determined in foreign exchange markets depending on demand and supply, and it generally fluctuates constantly.

➤ **Mortgage**

A mortgage is a debt instrument, secured by the collateral of specified real estate property that the borrower is obliged to pay back with a predetermined set of payments.

➤ **Pledge**

Cash deposit or placing of owned property by a debtor (the pledger) to a creditor (the pledgee) as a security for a loan or obligation. The pledgee has an implied right to confiscate and/or sell the pledged property to satisfy his or her claim in case of a default.

➤ **Hypothecation**

Hypothecation is legal term that refers to the granting of a hypothec to a lender by a borrower. In practice, the borrower pledges an asset as collateral for a loan, while retaining ownership of the assets and enjoying the benefits therefrom. The term comes from civil law; although its usage varies from jurisdiction to jurisdiction, it is nearly synonymous to a lien or mortgage.

➤ **Collateral Security**

Collateral' Property or other assets that a borrower offers a lender to secure a loan. If the borrower stops making the promised loan payments, the lender can seize the collateral to recoup its losses.

➤ **Factor**

A factor allows a business to obtain immediate capital based on the future income attributed to a particular amount due on an account receivable or business invoice. Accounts receivable function as a record of the credit extended to another party where payment is still due. Factoring allows other interested parties to purchase the funds due at a discounted price in exchange for providing cash up front.

➤ **Business Analysis**

Business analysis is a research discipline of identifying business needs and determining solutions to business problems. Solutions often include a software-systems development component, but may also consist of process improvement, organizational change or strategic planning and policy development.

➤ **Business Analyst**

A business analyst (BA) is someone who analyzes an organization or business domain (real or hypothetical) and documents its business or processes or systems, assessing the business model or its integration with technology.

➤ **Issued capital cannot be higher than?**

Authorized Capital

➤ **What is security?**

A security is a financial instrument issued by a business entity or government, which gives the buyer the right to either interest payments or a share of the earnings of the issuer. Securities form a key part of the financing structure of an economy. Examples of securities are stocks, bonds, options, and warrants. The concept can also refer to the collateral on a loan, which gives a lender the right to take possession of the collateral if a borrower cannot pay back a loan.

➤ **Merger**

A merger takes place when two companies combine together as equals to form an entirely new company. Mergers are rare, since most often companies are acquired by other companies, and it is more of absorption of operation of the target company. The term merger is more often used to show deference to employees and former owners when another company is taken over.

The following are the types of mergers

1. **Horizontal mergers:** It refers to two firms operating in same industry or producing ideal products combining together. For e.g., in the banking industry in India, acquisition of Times Bank by HDFC Bank, Bank of Madura by ICICI Bank, Nedungadi Bank by Punjab National Bank etc. in consumer electronics, acquisition of Electrolux's Indian operations by Videocon International Ltd., in BPO sector, acquisition of Daksh by IBM, Spectramind by Wipro etc. The main objectives of horizontal mergers are to benefit from economies of scale, reduce competition, achieve monopoly status and control the market.
2. **Vertical merger:** A vertical merger can happen in two ways. One is when a firm acquires another firm which produces raw materials used by it. For e.g., a tyre manufacturer acquires a rubber manufacturer, a car manufacturer acquires a steel company, a textile company acquires a cotton yarn manufacturer etc. Another form of vertical merger happens when a firm acquires another firm which would help it get closer to the customer. For e.g., a consumer durable manufacturer acquiring a consumer durable dealer, an FMCG company acquiring an advertising company or a retailing outlet etc.
3. **Conglomerate merger:** It refers to the combination of two firms operating in industries unrelated to each other. In this case, the business of the target company is entirely different from those of the acquiring company. For e.g., a watch manufacturer acquiring a cement manufacturer, a steel manufacturer acquiring a software company etc. The main objective of a conglomerate merger is to achieve a big size.
4. **Concentric merger:** It refers to combination of two or more firms which are related to each other in terms of customer groups, functions or technology. For eg., combination of a computer system manufacturer with a UPS manufacturer.

5. **Forward merger:** In a forward merger, the target merges into the buyer. For e.g., when ICICI Bank acquired Bank of Madura, Bank of Madura which was the target, merged with the acquirer, ICICI Bank.

6. **Reverse merger:** In this case, the buyer merges into the target and the shareholders of the buyer get stock in the target. This is treated as a stock acquisition by the buyer.

7. **Subsidiary merger:** A subsidiary merger is said to occur when the buyer sets up an acquisition subsidiary which merges into the target.

➤ **Corporate governance**

Corporate governance is the system of rules, practices and processes by which a company is directed and controlled. Corporate governance essentially involves balancing the interests of a company's many stakeholders, such as shareholders, management, customers, suppliers, financiers, government and the community.

➤ **Functions of Finance Manager**

Some of the major functions of a financial manager are as follows:

1. **Estimating the Amount of Capital Required:** This is the foremost function of the financial manager. Business firms require capital for: (i) purchase of fixed assets, (ii) meeting working capital requirements, and (iii) modernization and expansion of business.

2. **Determining Capital Structure:** financial manager has to determine the proper mix of equity and debt and short-term and long-term debt ratio. This is done to achieve minimum cost of capital and maximize shareholders wealth.

3. **Choice of Sources of Funds:** Before the actual procurement of funds, the finance manager has to decide the sources from which the funds are to be raised like from equity shareholders, preference shareholders, debenture- holders, banks and other financial institutions, public deposits, etc.

4. **Procurement of Funds:** The financial manager takes steps to procure the funds required for the business. It might require negotiation with creditors and financial institutions, issue of prospectus, etc.

5. **Utilization of Funds:** The funds procured by the financial manager are to be prudently invested in various assets so as to maximize the return on investment

6. **Disposal of Profits or Surplus:** The financial manager has to decide how much to retain for ploughing back and how much to distribute as dividend to shareholders out of the profits of the company.

7. **Management of Cash:** Management of cash and other current assets is an important task of financial manager. It involves forecasting the cash inflows and outflows to ensure that there is neither shortage nor surplus of cash with the firm

8. **Financial Control:** Evaluation of financial performance is also an important function of financial manager. The overall measure of evaluation is Return on Investment (ROI).

➤ **Modaraba**

‘Modaraba’ is a kind of partnership, wherein one party provides finance to other party for the purpose of carrying on business. The party who provides the finance is called the “Rabb-ul-Mal” (the provider of capital), whereas the other party who puts in his expertise and management skills is called the “Modarib” (manager).

➤ **Modaraba Company**

The Companies incorporated under the Companies Ordinance, 1984 and registered with the Registrar (Modarabas), SECP are eligible to undertake floatation and management of Modarabas.

➤ **Difference between Trade and Commerce**

Trade simply means buying and selling of goods and services in return for money or money’s worth whereas commerce not only refers to the exchange of goods and services but also includes all those activities that are vital for the completion of that exchange such as insurance, transportation, warehousing, advertising etc that completes that exchange.

➤ **Marketable securities**

Marketable securities are securities or debts that are to be sold or redeemed within a year. These are financial instruments that can be easily converted to cash such as government bonds, common stock or certificates of deposit.

➤ **Public finance**

Public finance is the study of the role of the government in the economy. It is the branch of economics which assesses the government revenue and government expenditure of the public authorities and the adjustment of one or the other to achieve desirable effects and avoid undesirable ones.

➤ **Non-banking institutions**

Non-banking financial companies, or NBFCs, are financial institutions that provide certain types of banking services, but do not hold a banking license. Generally, these institutions are not allowed to take deposits from the public, which keeps them outside the scope of traditional oversight required under banking regulations. NBFCs can offer banking services such as loans and credit facilities, retirement planning, money markets, underwriting, and merger activities.

➤ **Define strategic planning**

Strategic planning is an organization's process of defining its strategy, or direction, and making decisions on allocating its resources to pursue this strategy. It may also extend to control mechanisms for guiding the implementation of the strategy.

➤ **Corporate Social Responsibility**

Corporate social responsibility (CSR) refers to business practices involving initiatives that benefit society. A business's CSR can encompass a wide variety of tactics, from giving away a portion of a company's proceeds to charity, to implementing "greener" business operations.

➤ **World Bank vs. IMF**

The primary difference between the International Monetary Fund, or IMF, and the World Bank lies in their respective purposes and functions. The IMF exists primarily to stabilize exchange rates, while the World Bank's goal is to reduce poverty. ... The loans offered by the IMF, however, are loaded with conditions.

➤ **Difference between Public Finance and Development Finance**

Public finance is the study of the role of the government in the economy. It is the branch of economics which assesses the government revenue and government expenditure of the public authorities and the adjustment of one or the other to achieve desirable effects and avoid undesirable ones. A development finance institution (DFI) is an alternative financial institution which includes microfinance institutions, community development financial institution and revolving loan funds. ... DFIs are backed by states with developed economies.

➤ **APR**

An annual percentage rate (APR) is the annual rate charged for borrowing or earned through an investment, and is expressed as a percentage that represents the actual yearly cost of funds over the term of a loan.

➤ **Bretton woods agreement**

The Bretton Woods Agreement is the landmark system for monetary and exchange rate management established in 1944. It was developed at the United Nations Monetary and Financial Conference held in Bretton Woods, New Hampshire, from July 1 to July 22, 1944. Under the agreement, currencies were pegged to the price of gold, and the U.S. dollar was seen as a reserve currency linked to the price of gold.

➤ **Objectives of state bank of Pakistan**

The State Bank of Pakistan frames and operators the monetary policy. Monetary policy is conducted by the State Bank of Pakistan to regulate and control the volume of money and credit supply in the country in order to achieve specific economic objectives such as price stability, reducing unemployment, etc. The main instruments of monetary policy are (i) Open market operations (ii) Changing the reserve requirement and (iii) Changing the discount rate.

➤ **Company Incorporation procedure**

Formation of company in Pakistan is relatively easy thanks to the Securities and Exchange Commission's eServices. Now you can incorporate your company just 2 visits to the office of SECP near you and incorporate your company online from SECP's eservices. Once the company is incorporated You can file the tax annual reports and make all types of changes in the company with your digital signature.

Requirements for Incorporations in Pakistan.

To incorporate a Private Limited or LLC company in Pakistan you will require the following document.

1. Your National ID Card Color Scanned copy (For Pakistani Nationals) Passport in case of foreign Nationals. Each Director needs to have either NIC or passport
2. A filled and formulated Memorandum of association detailing all the tasks a company will perform
3. A filled article of association
4. Digital Signatures from NIFT (Pakistan) for each director.
5. An address for your company in any one province of Pakistan or Federal Territory

6. Necessary Fees to be paid at any MCB Bank branch

Steps of Incorporation in Pakistan

1. First step is to visit the web site of SECP and create an account there
2. Fill out the company Name search form online
3. Pay the fees of Rs. 200 thru the chalan printed from the SECP web site
4. Deposit the original chalan at SECP
5. Collect the name availability certificate from SECP maximum 3 days
6. Decide on who will be the directors or whether it will be a Single Member company
7. Make Memorandum of Understanding
8. Upload the ID cards, Memorandum and Article in PDF format on SECP eservices web site
9. Incorporation fee chalan will now be available print and pay the chalan
10. Obtain digital signature for you from NIFT one day process
11. Sign all forms on SECP thru the Digital Signature and click Submit to SECP
12. In next 3 - 4 days you will receive an email from SECP about confirmation of incorporation your Incorporation certificate will be sent by post to your office address.

➤ **Types of financial institutions**

- Commercial Banks
- Credit Unions
- Stock Brokerage Firms
- Asset Management Firms
- Insurance Companies
- Finance Companies
- Building Societies
- Retailers

➤ **Bilateral Loan**

Bilateral loans are funds provided to a borrower by one lender. The opposite of syndicated loans, bilateral loans are a less complicated type of participatory loan. However, because bilateral loans are agreements between one lender and one borrower, the lender risk is much higher than with syndicated loans.

➤ **Multilateral Loan**

Multilateral debt is the debt owed by developing countries to the World Bank and International Monetary Fund (IMF), known as the Bretton Woods Institutions (BWIs). In the last decade these institutions have become the major creditors of the developing world.

➤ **Bonds**

There are many types of bonds that can be issued, each of which is tailored to the specific needs of either the issuer or investors. The large number of bond variations is needed to create the best possible match of funding sources and investment risk profiles.

When an issuing entity (usually a corporation) sells a fixed obligation to investors, this is generally described as a bond. The typical bond has a face value of \$1,000, which means that the issuer is obligated to pay the investor \$1,000 on the maturity date of the bond. If investors feel that the stated interest rate on a bond is too low, they will only agree to buy the bond at a price lower than its stated amount, thereby increasing the effective interest rate that they will earn on the investment. Conversely, a high stated interest rate can lead investors to pay a premium for a bond.

When a bond is registered, the issuer is maintaining a list of which investors own its bonds. The issuer then sends periodic interest payments directly to these investors. When the issuer does not maintain a list of investors who own its bonds, the bonds are considered to be coupon bonds. A coupon bond contains attached coupons that investors send to the issuer; these coupons obligate the company to issue interest payments to the holders of the bonds. A coupon bond is easier to transfer between investors, but it is also more difficult to establish ownership of the bonds.

There are many types of bonds. The following list represents a sampling of the more common types:

- *Collateral trust bond.* This bond includes the investment holdings of the issuer as collateral.
- *Convertible bond.* This bond can be converted into the common stock of the issuer at a predetermined conversion ratio.
- *Debenture.* This bond has no collateral associated with it. A variation is the subordinated debenture, which has junior rights to collateral.

- *Deferred interest bond.* This bond offers little or no interest at the start of the bond term, and more interest near the end. The format is useful for businesses currently having little cash with which to pay interest.
- *Guaranteed bond.* The payments associated with this bond are guaranteed by a third party, which can result in a lower effective interest rate for the issuer.
- *Income bond.* The issuer is only obligated to make interest payments to bond holders if the issuer or a specific project earns a profit. If the bond terms allow for cumulative interest, then the unpaid interest will accumulate until such time as there is sufficient income to pay the amounts owed.
- *Mortgage bond.* This bond is backed by real estate or equipment owned by the issuer.
- *Serial bond.* This bond is gradually paid off in each successive year, so the total amount of debt outstanding is gradually reduced.
- *Variable rate bond.* The interest rate paid on this bond varies with a baseline indicator, such as LIBOR.
- *Zero coupon bond.* No interest is paid on this type of bond. Instead, investors buy the bonds at large discounts to their face values in order to earn an effective interest rate.
- *Zero coupon convertible bond.* This variation on the zero coupon bond allows investors to convert their bond holdings into the common stock of the issuer. This allows investors to take advantage of a run-up in the price of a company's stock. The conversion option can increase the price that investors are willing to pay for this type of bond.

Additional features can be added to a bond to make it easier to sell to investors at a higher price. These features can include:

- *Sinking fund.* The issuer creates a sinking fund to which cash is periodically added, and which is used to ensure that bonds are eventually paid off.
- *Conversion feature.* Bond holders have the option to convert their bonds into the stock of the issuer at a predetermined conversion rate.
- *Guarantees.* The repayment of a bond may be guaranteed by a third party.
The following additional bond features favor the issuer, and so may reduce the price at which investors are willing to purchase bonds:
- *Call feature.* The issuer has the right to buy back bonds earlier than the stated maturity date.
- *Subordination.* Bond holders are positioned after more senior debt holders to be paid back from issuer assets in the event of a default.

➤ **Fund Manager**

A fund manager is responsible for implementing a fund's investing strategy and managing its portfolio trading activities. A fund can be managed by one person, by two people as co-managers, or by a team of three or more people. Fund managers are paid a fee for their work, which is a percentage of the fund's average assets under management (AUM).

➤ **Mutual Fund**

A mutual fund is an investment vehicle made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. A mutual fund's portfolio is structured and maintained to match the investment objectives stated in its prospectus.

Income & Sale Tax

➤ **Taxes, Direct & Indirect Taxes**

A fee charged ("levied") by a government on a product, income, or activity. If tax is levied directly on personal or corporate income, then it is a **direct tax**. If tax is levied on the price of a good or service, then it is called an **indirect tax**. The purpose of taxation is to finance government expenditure. One of the most important uses of taxes is to finance public goods and services, such as street lighting and street cleaning. Since public goods and services do not allow a non-payer to be excluded, or allow exclusion by a consumer, there cannot be a market in the good or service, and so they need to be provided by the government or a quasi-government agency, which tend to finance themselves largely through taxes.

➤ **Withholding Tax**

Withholding tax is income tax withheld from employees' wages and paid directly to the government by the employer, and the amount withheld is a credit against the income taxes the employee must pay during the year. It also is a tax levied on income (interest and dividends) from securities owned by a nonresident as well as other income paid to nonresidents of a country.

➤ **Sales Tax**

A sales tax is a consumption tax imposed by the government on the sale of goods and services. A conventional sales tax is levied at the point of sale, collected by the retailer and passed on to the government. A business is liable for sales taxes in a given jurisdiction if it has a nexus there, which can be a brick-and-mortar location, an employee, an affiliate, or some other presence, depending on the laws in that jurisdiction.

➤ **Income Tax**

An income tax is a tax that governments impose on financial income generated by all entities within their jurisdiction. By law, businesses and individuals must file an income tax return every year to determine whether they owe any taxes or are eligible for a tax refund. Income tax is a key source of funds that the government uses to fund its activities and serve the public.

➤ **Property Tax**

Property tax is a tax assessed on real estate. The tax is usually based on the value of the property (including the land) you own and is often assessed by local or municipal governments.

➤ **Capital Gains**

Capital gain is an increase in the value of a capital asset (investment or real estate) that gives it a higher worth than the purchase price. The gain is not realized until the asset is sold. A capital gain may be short-term (one year or less) or long-term (more than one year) and must be claimed on income taxes.

➤ **WHT Agent**

A withholding agent may be an individual, corporation, partnership, trust, association, or any other entity, including any foreign intermediary, foreign partnership, branch of certain foreign banks and insurance companies.

➤ **Value Added Tax (VAT)**

A tax on the amount by which the value of an article has been increased at each stage of its production or distribution

Management, Marketing & Human Resource

➤ **Management and Its Function**

Management is the process of reaching organizational goals by working with and through people and other organizational resources.

Management has the following 3 characteristics:

1. It is a process or series of continuing and related activities.
2. It involves and concentrates on reaching organizational goals.
3. It reaches these goals by working with and through people and other organizational resources.

MANAGEMENT FUNCTIONS:

The 4 basic management functions that make up the management process are described in the following sections:

1. PLANNING
2. ORGANIZING
3. INFLUENCING
4. CONTROLLING.

PLANNING: Planning involves choosing tasks that must be performed to attain organizational goals, outlining how the tasks must be performed, and indicating when they should be performed.

Planning activity focuses on attaining goals. Managers outline exactly what organizations should do to be successful. Planning is concerned with the success of the organization in the short term as well as in the long term.

ORGANIZING:

Organizing can be thought of as assigning the tasks developed in the planning stages, to various individuals or groups within the organization. Organizing is to create a mechanism to put plans into action.

People within the organization are given work assignments that contribute to the company's goals.

Tasks are organized so that the output of each individual contributes to the success of departments, which, in turn, contributes to the success of divisions, which ultimately contributes to the success of the organization.

INFLUENCING:

Influencing is also referred to as motivating, leading or directing. Influencing can be defined as guiding the activities of organization members in the direction that helps the organization move towards the fulfillment of the goals.

The purpose of influencing is to increase productivity. Human-oriented work situations usually generate higher levels of production over the long term than do task oriented work situations because people find the latter type distasteful.

CONTROLLING:

Controlling is the following roles played by the manager:

1. Gather information that measures performance
2. Compare present performance to pre-established performance norms.
3. Determine the next action plan and modifications for meeting the desired performance parameters.

Controlling is an ongoing process.

➤ **Management (Science or Art)**

It is considered as a science because it has an organized body of knowledge which contains certain universal truth. It is called an art because managing requires certain skills which are personal possessions of managers. Science provides the knowledge & art deals with the application of knowledge and skills.

➤ **Financial Risk Management**

The process of evaluating and managing current and possible financial risk at a firm as a method of decreasing the firm's exposure to the risk. Financial risk managers must identify the risk, evaluate all possible remedies, and then implement the steps necessary to alleviate the risk. These risks are typically remedied by using certain financial instruments as a method of counteracting possible ramifications.

Financial risk management cannot prevent a firm from all possible risks because some are unexpected and cannot be addressed quickly enough.

➤ **Strategic Management**

Strategic management is the management of an organization's resources to achieve its goals and objectives. Strategic management involves setting objectives, analyzing the competitive environment, analyzing the internal organization, evaluating strategies and ensuring that management rolls out the strategies across the organization. At its heart, strategic management involves identifying how the organization stacks up compared to its competitors and recognizing opportunities and threats facing an organization, whether they come from within the organization or from competitors.

➤ **Marketing Management**

Marketing management is the organizational discipline which focuses on the practical application of marketing orientation, techniques and methods inside enterprises and organizations and on the management of a firm's marketing resources and activities.

➤ **X and Y theory**

In 1960, Douglas McGregor formulated Theory X and Theory Y suggesting two aspects of human behavior at work, or in other words, two different views of individuals (employees): one of which is negative, called as Theory X and the other is positive, so called as Theory Y. According to McGregor, the perception of managers on the nature of individuals is based on various assumptions. Assumptions of Theory X

- An average employee intrinsically does not like work and tries to escape it whenever possible.
- Since the employee does not want to work, he must be persuaded, compelled, or warned with punishment so as to achieve organizational goals. A close supervision is required on part of managers. The managers adopt a more dictatorial style.
- Many employees rank job security on top, and they have little or no aspiration/ ambition.
- Employees generally dislike responsibilities.
- Employees resist change.
- An average employee needs formal direction.

Assumptions of Theory Y

- Employees can perceive their job as relaxing and normal. They exercise their physical and mental efforts in an inherent manner in their jobs.
- Employees may not require only threat, external control and coercion to work, but they can use self-direction and self-control if they are dedicated and sincere to achieve the organizational objectives.
- If the job is rewarding and satisfying, then it will result in employees' loyalty and commitment to organization.
- An average employee can learn to admit and recognize the responsibility. In fact, he can even learn to obtain responsibility.
- The employees have skills and capabilities. Their logical capabilities should be fully utilized. In other words, the creativity, resourcefulness and innovative potentiality of the employees can be utilized to solve organizational problems.

Thus, we can say that Theory X presents a pessimistic view of employees' nature and behavior at work, while Theory Y presents an optimistic view of the employees' nature and behavior at work. If correlate it with Maslow's theory, we can say that Theory X is based on the assumption that the employees emphasize on the physiological needs and the safety needs; while Theory Y is based on the assumption that the social needs, esteem needs and the self-actualization needs dominate the employees.

McGregor views Theory Y to be more valid and reasonable than Theory X. Thus, he encouraged cordial team relations, responsible and stimulating jobs, and participation of all in decision-making process. Implications of Theory X and Theory Y

- Quite a few organizations use Theory X today. Theory X encourages use of tight control and supervision. It implies that employees are reluctant to organizational changes. Thus, it does not encourage innovation.
- Many organizations are using Theory Y techniques. Theory Y implies that the managers should create and encourage a work environment which provides opportunities to employees to take initiative and self-direction. Employees should be given opportunities to contribute to organizational well-being. Theory Y encourages decentralization of authority, teamwork and participative decision making in an organization. Theory Y searches and discovers the ways in which an employee can make significant contributions in an organization. It harmonizes and matches employees' needs and aspirations with organizational needs and aspirations.

➤ **Weberian theory of bureaucracy**

Max Weber was a historian that wrote about the emergence of bureaucracy from more traditional organizational forms (like feudalism) and its rising pre-eminence in modern society. Scott defines bureaucracy as "the existence of a specialized administrative staff". According to Weber, bureaucracy is a particular type of administrative structure developed through rational-legal authority. Bureaucratic structures evolved from traditional structures with the following changes:

1. Jurisdictional areas are clearly specified, activities are distributed as official duties (unlike traditional form where duties delegated by leader and changed at any time).
2. Organization follows hierarchical principle -- subordinates follow orders or superiors, but have right of appeal (in contrast to more diffuse structure in traditional authority).
3. Intentional, abstract rules govern decisions and actions. Rules are stable, exhaustive, and can be learned. Decisions are recorded in permanent files (in traditional forms few explicit rules or written records).
4. Means of production or administration belong to office. Personal property separated from office property.
5. Officials are selected on basis of technical qualifications, appointed not elected, and compensated by salary.
6. Employment by the organization is a career. The official is a full-time employee and looks forward to a life-long career. After a trial period they get tenure of position and are protected from arbitrary dismissal.

Weber said that bureaucracy resolves some of the shortcomings of the traditional system. Described above was his ideal-type construct, a simplified model (not a preferred model) that focuses on the most important features.

Weber's view of bureaucracy was a system of power where leaders exercise control over others -- a system based on discipline.

Weber stressed that the rational-legal form was the most stable of systems for both superiors and subordinates -- it's more reliable and clear, yet allows the subordinate more independence and discretion. Subordinates ideally can challenge the decisions of their leaders by referring to the stated rules -- charisma becomes less important. As a result, bureaucratic systems can handle more complex operations than traditional systems. (all above Scott p. 41-42).

Bureaucracy and Unresponsiveness

Often public service organizations are criticized for being unresponsive to their customer's needs. One of Weber's most serious concerns was how society would maintain control over expanding state bureaucracies. He felt the most serious problem was not inefficiency or mismanagement but the increased power of public officials. A person in an important, specialized position will begin to realize how dependent their bosses are on their expertise and begin to exercise their power in that position. Furthermore, the staff also begin to associate with the special social interests of their particular group or organization. Over history this has caused the shift in power from the leaders of society to the bureaucrats.

There were numerous criticisms of Weber's theories over the years.

➤ **Participative Management**

Type of management in which employees at all levels are encouraged to contribute ideas towards identifying and setting organizational-goals, problem solving, and other decisions that may directly affect them. Also called consultative management.

➤ **ERP**

Enterprise resource planning (ERP) is business process management software that allows an organization to use a system of integrated applications to manage the business and automate many back-office functions related to technology, services and human resources.

➤ **Marketing**

Marketing are activities of a company associated with buying and selling a product or service. It includes advertising, selling and delivering products to people. People who work in marketing departments of companies try to get the attention of target audiences by using slogans, packaging design, celebrity endorsements and general media exposure.

➤ **Reverse Marketing**

Reverse marketing is the concept of marketing in which the customer seeks the firm rather than marketers seeking the customer. Usually, this is done through traditional means of advertising, such as television advertisements, print magazine advertisements and online media.

➤ **4 P's of Marketing**

People
Product,
Price
Promotion
Place
Process
Physical Evidence

➤ **POLC Management**

Planning
Organizing
Leading
Controlling

General Knowledge

➤ **Sheikh Saadi’s Famous Book**

Gulistan

➤ **Currencies**

France	Euro	113.80 PKR
Germany	Euro	113.80 PKR
China	Chinese Yuan	15.17

➤ **What is Ten Downing Street in London?**

10 Downing Street has been used as a home for British prime ministers since 1735, when King George II gave the house to then-Prime Minister Robert Walpole.

The building's black front door is well-known, but few have had a look behind the iconic brick facade. Now, thanks to Eye Revolution, the public can take a virtual tour of Number 10's inner-guts.

We've pulled together screenshots from Eye Revolution's 360-degree tour to give you a glimpse inside the elegant rooms of Number 10.

➤ **Census in Pakistan**

The sixth census is underway these days after a gap of almost two decades. After delaying it twice and the civilian government dragging its feet; it is finally being conducted on strict directions of the Supreme Court. Around 200,000 soldiers are helping 91,000 civilian enumerators who will go to every house to get the forms filled. The first census of Pakistan was conducted in 1951, the second in 1961 while the third census was held in 1972 instead of 1971 due to political environment in the country and war with India. The fourth census was held in March 1981 and the fifth one, which was due in 1991 was held in 1998. In these 19 years, the demographic and social landscape of Pakistan has completely changed. Rapid urbanization, population displacement due to security operations and natural disasters has had a tremendous impact on settlement patterns.

The census is a periodic activity and must be conducted regularly because it carries lot of benefits for the country. It allows us to compare different groups of people across the country. It provides information regarding parts of the country the government needs to develop policies for, plan and run public services in and allocate funding to. It tells us how many people work in different occupations and industries, about new jobs and training policies; investment decisions are also made on the basis of the census.

According to a research report by UNDP, every year, Pakistan needs more than 1.5 million jobs for the youth entering the workforce.

Residential mobility data can provide an understanding of spatial differences in socio-economic status and how these change over time. Estimates of the required scale of future health, education and other essential services are based on population projections. National and regional population projections are also crucial to estimating the environmental impact of population growth, allocation of water resources, land use or other factors. The census does not remain the same; it evolves to answer relevant contemporary questions.

For the first time in this census, transgender persons will be counted separately and this is a historical move. Enumerators have three choices for their gender; they can choose between man, woman, or declare themselves transgender. The census will also provide an insight into the true number of religious minorities, especially Christians and Hindus. Citizens can declare themselves Muslim, Christian, Hindu or Ahmadi. There are no separate options for Sikhs, Parsis or Baha’i. There is also a count for toilets this time. About nationality, the form gives two options – Pakistani or foreign.

When it comes to languages, many communities expressed their dismay because only nine out of the country’s estimated 70 languages are listed. No regional language is included. The other concerns are that the estimated six million Pakistanis working abroad will miss out on the count. Similarly, no

information will be collected on internal migration, which is necessary to assess the political weight of a province where many people have moved for economic reasons.

A census always has deep political repercussions and that is why it is evaded by political governments. This census also brings some major changes which will also affect the electoral politics of Pakistan, especially in Punjab. According to an estimate, at least 40 million people have increased in this province alone. This may have an impact on PML-N's monopoly over Punjab. The making of new provinces in Punjab may become inevitable. Similarly, the rising number of Pashtuns in Karachi and declining number of Urdu speaking persons will also have political ramifications which many would like to avoid. Another direct implication of this census will be for resource distribution. This government will have to give an equal share to all the provinces in all fields.

The people must be duly informed about the indispensable importance of a census in national life. According to an estimate, this census will cost Rs 18 billion. It is not just about statistics, the political status quo stands to be challenged, rather, the census will have a profound impact on the distribution of federal resources and the allocation of legislative power in the National Assembly. It will give insights into urbanization trends and can be very effectively used for devising law enforcement strategies, security infrastructure and better local governments. All political parties should be prepared to let go and work with new ground realities. The provincial governments should participate in ensuring a credible consensus. They are now stakeholders. Blame game should be avoided at all costs. This census should be transparent and its data should be released immediately and be available to research communities to shun doubts and confusions.

➤ **NFC**

Introduction.

NFC – National Finance Commission is a constitutional body set up for the distribution of financial resources among the provinces by federal government on annual basis, called National Finance Commission Award. Certain types of taxes collected in each province are pooled, and then redistributed according to the NFC formula.

Constitutional Provision of NFC.

NFC is constituted under Article 160(1) of the 1973 constitution (Annex I) and proposed to be held at the intervals of five years.

Composition of NFC.

Federal Finance Minister – Chairman

Provincial Finance Ministers and other concerning experts which the President may appoint after consultation with provincial Governors [Constitution of Pakistan (1973)].

Main Charter of NFC.

(1) The distribution of specified taxes, duties between federation and provinces.

(2) The disbursement of grants to provincial governments.

(3) The borrowing powers exercised by federal and provincial governments.

(4) Any other financial matter referred to commission.

➤ **Last NFC Award**

In 2010, the seventh NFC award was successfully enacted by President Asif Zardari after reaching a united concessions with the four provinces. The 7th NFC expired on June 30, 2015, and it has since been on repeated extensions through presidential extensions.

➤ **CPEC**

Main stakeholders of CPEC

Pakistan

China

Note: both above regional players have government and private sector included stakeholders in CPEC. Strength of CPEC

Gawadar port and international airport.

Crude oil depot and oil refinery at

Gawadar. Highway Structure (3000 km).

Railway structure (1100 km, Kashgar to Islamabad and rehabilitation of existing rail structure in Pakistan).

Pakistan-China strategic relationship (china daily,

2013). Petroleum transportation.

Energy infrastructure 21,690 MW (Pakistan today, 2014).

Telecommunication (optical fiber cable from china border to Rawalpindi).

Research activities (joint research cotton biotechnology research center).

Opening doors for Pakistani market to European, Middle east, Gulf countries, Russia and Africa

Weaknesses of CPEC

1) Political viewpoints on rout of roads.

2) Lack of fund usage transparency.

3) Lack of seriousness on project implementation.

4) Lack of long term and non-interrupting internal (local) and external (foreign) policies.

Opportunities of CPEC

Infrastructure buildup including roads and railway track up gradation.

Job opportunities for all Pakistan.

Very huge international investment

III. Economic empowerment to poor and backward areas like Baluchistan, FATA and north Sind, Gilgit baltistan, North-West China regions including Xinjiang.

Joint research activities in various areas of life and technology

Great opportunities for local and foreign investors in region like Iran and Gulf countries

Increase demand of education, security and health will provide better lifestyle accurse the corridor.

VII. Building up several industrial zones along with highway and rail structure.

VIII. Iran-Pakistan and China gas pipeline.

Threats of CPEC

Security threats from Xinjiang separating militant groups

Tehreek-e-Taliban and other terrorist groups like BLA.

Insurgent activities of traitors in supported by RAW, CIA and MOSSAD in region. U.S, Afghanistan and Indian foreign policies towards Pakistan.

Conclusion

The China-Pakistan economic corridor will be the game changer for the Pakistan. It is our duty to support this corridor and encourage those who have low in power and facilities like Baluchistan, FATA and Sind. Planners should improve the map by delivering and connecting more to needy and also encourage most populated and existing industrial zone. Government should stretch its planning and increase the number of stakeholders for CPEC to get maximum juice of this joint step of Pakistan and China governments. Long live Pak-China friendship.

➤ **Location of dams**

Mangla Dam	Jhelum River
Tarbela Dam	Indus River
Hub Dam	Hub River
Mirani Dam	Dasht River
Sabakzai Dam	Zohb River
Gomal Zam Dam	Gomal River
Allai Khwar Dam	Allai Khwar River
Duber Khwar Dam	Duber Khwar Dam
Warsak Dam	Kabul River
Khanpur Dam	Haro River

➤ **Personalities in Pakistan movement**

Muhammad Ali Jinnah (1876–1948)

Allama Mohammad Iqbal (1877–1938)

Aga Khan III (1877–1957)

Liaquat Ali Khan (1895–1951)
Fatima Jinnah (1893–1965)
Sir Muhammad Zafarullah Khan (1893–1985)
Fazlul Huq (1873–1962)
Khawaja Nazimuddin (1894–1964)
Rahmat Ali (1895–1951)
Bahadur Yar Jung (1905–1944)
Raja Ghazanfar Ali Khan (1895–1963)
G. M. Syed (1905–1995)
Abdur Rab Nishtar (1899–1958)
Huseyn Suhrawardy (1892–1963)
Mohammad Ali Jouhar (1878–1931)
Shaukat Ali (1873–1939)
Jalal-ud-din Jalal Baba (1903–1981)
Zafar Ali Khan (1873–1956)
Ra'ana Ali Khan (1905–1990)
Jogendra Nath Mandal (1904–1968)
Victor Turner (1894–1972)
Khaliq-uz-Zaman (1899–1963)
Jahanara Shahnawaz (1896–1979)
Nasir Ahmad Malhi (1903–1991)

➤ **Presidents**

Iran	Hassan Rouhani
Afghanistan	Ashraf Ghani

➤ **Secretary of USA**

Rex W. Tillerson

➤ **CCI**

Council of Common Interests or CCI is a constitutional body in Pakistan. The CCI resolves the disputes of power sharing between the federation and provinces.

"CCI was formed under 1973 constitution. Until 2010 the body worked under Cabinet Division. After 18th amendment the body was transferred under Ministry of Inter Provincial Coordination in March 2010.

Membership of CCI consists of following:

The Prime Minister of Pakistan

All four Provincial Chief Ministers

Three members to be nominated by Prime Minister (Usually Cabinet members)

After passage of the Eighteenth Constitutional Amendment, it is mandatory for the Council to meet once in ninety days."

➤ **Institutional hierarchy of finance sector (starting from ministry)**

MoF is subdivided into three divisions:

1. Finance: The Finance Division (FD) is the most elite bureaucratic division under the Finance Ministry's purview. The FD comes under the supervision of the Secretary of Finance, an office held by Dr Waqar Masood Khan as of 2014.

The division's bureaucracy is divided into several wings and units as listed below:

- A. HRM Wing
- B. Corporate finance Wing
- C. Economic advisor's wing
- D. Expenditure wing

The FD also delegates its functions to specialized sub-departments within the division, which include the following:

- a. Auditor General of Pakistan

The Auditor General's organization is the prime institution in the country for ensuring public accountability and fiscal transparency in governmental operations. The organization is expected to bring about improvements in the financial discipline and internal control environment in the executive departments for minimizing the possibility of waste and fraud.

b. Accountant General Pakistan Revenues (AGPR) is responsible for the centralized accounting and reporting of federal transactions. Additionally the AGPR is responsible for the consolidation of summarized financial information prepared by federal self-accounting entities. The AGPR receives accounts and reports from the DAOs, PAOs, Federal Treasuries and SBP/NBP, and provide Annual Accounts (to the AGP) and Consolidated Monthly Accounts (to the Federal Finance Division). There are AGPR sub-offices in each of the Provinces who also act as the DAO in respect of Federal Government transactions relevant to the Provincial Headquarters. The Controller General of Accounts is the administrative head of the AGPR.

c. Controller General of Accounts

The Controller General of Accounts (CGA) is the premier accounting office of the Government of Pakistan. The Office is entrusted with the task of producing accurate and timely financial statements for the federation. It was formed under an ordinance issued in 2001. The Office achieves task through dedicated human resources, immense investment in infrastructure and strict quality control checks by the Senior Officers. It is also responsible for disbursing government money in form of payments of salaries and allowances to government servants and payments to contractors. All these transactions and any other transactions by Government of Pakistan, are captured in the SAP ERP and then the information is used to generate monthly, quarterly and yearly financials. The Controller General of Accounts is appointed by the President from amongst the officers of the Accounts Group and shall hold a civil service rank of BPS 22.

➤ **Financial Regulatory Authorities**

Securities and Exchange Commission of Pakistan

➤ **NEC**

As per constitution

Article 156: National Economic Council

1. The President shall constitute a National Economic Council which shall consist of

- a. the Prime Minister, who shall be the Chairman of the Council;

b. the Chief Ministers and one member from each Province to be nominated by the Chief Minister; and

c. Four other members as the Prime Minister may nominate from time to time.

2. The National Economic Council shall review the overall economic condition of the country and shall, for advising the Federal Government and the Provincial Governments, formulate plans in respect of financial, commercial, social and economic policies; and in formulating such plans it shall, amongst other factors, ensure balanced development and regional equity and shall also be guided by the Principles of Policy set out in Chapter 2 of Part-II.

➤ **Governors**

Khyber Pakhtunkhwa

Iqbal Zafar Jhagra

Balochistan

Muhammad Khan Achakzai

Sindh

Muhammad Zubair

Punjab

Muhammad Rafique Rajwana

Gilgit- Baltistan

Mir Ghazanfar Ali Khan

➤ **Corruption Reason and Solution**

Reasons for Corruption

Greed, the desire for power and the wish to advance oneself in society are primary reasons for corruption. Corruption typically flourishes in societies in which there is a high value placed on money, power and station in life. Its effects might include instability, distrust and unjustness.

Causes:

1: Political Causes

a. Corruption in Political System

b. Corruption in Political Leaders

c. Due to Corruption bad governance

d. Hinders in the way of accountability

2: Social Causes

a. Lack of Understanding about Corruption, it's forms and types

b. Illiteracy

c. Urbanization

3: Economic causes

- a. Poverty
- b. Unemployment
- c. Inconsistence economic growth and uncontrollable inflation

Solutions:

- 1: Equitable Accountability
- 2: Proper Research on Social Hierarchy to fathom the corruption triggers
- 3: Once the factors are known then later comes the education
- 4: Implementation of Possible solutions
- 5: Reward process

➤ **Chairman of FBR**

Dr. Muhammad Irshad

➤ **Current Auditor General of Pakistan**

Mr. Imran Iqbal (Additional Auditor General-I / Acting Auditor General of Pakistan) after the death of Sheikh Muhammad Sadiq.

Mr. Zafar Hasan Reza (Additional Auditor General-II)

GDP=4.24%, GDP(Prev) = 4.03%

Unemployment Rate=5.9 %

Inflation Rate= 3.66 %

Interest Rate= 5.75 %

BOT=-309673 PKR Million

Government Debt to GDP= 64.8 %

GDP= 271 USD Billion

GDP per capita= 1143 USD

Interbank Rate 5.98 %

Foreign Exchange Reserves 23200 USD Million

External Debt 74126 USD Million

Foreign Direct Investment 2761 USD Million

Corporate Tax Rate 32 %

Personal Income Tax Rate 20 %

Sales Tax Rate 17 %

Miscellaneous

- **Yours Name**
- **Name Meaning**
- **Your Age**
- **Father Name**
- **Father's Occupation**
- **Town Name**
- **Town Population**
- **Town History**
- **What is famous thing of Town**
- **Name famous civil servants of Town**
- **Important places in your Town**
- **MNA of Your Area**
- **MPA of Your Area**
- **Experience**
- **Strength & Weaknesses**
- **Family background**
- **Why have you applied for this post?**
- **What is famous in you?**
- **Your Role Model**

- Why do you want to be an Auditor?

Abbreviations

- **INTOSAI**
International Organization of Supreme Audit Institutions
- **ECOSAI**
Economic Co-operation Organization of Supreme Audit Institutions
- **DAC**
Departmental Accounts Committee
- **PAO**
Principal Accounting Officer
- **APPM**
Accounting Policies and Procedures Manual
- **PIFRA**
Project for the Improvement of Financial Reporting & Auditing