CHAPTER-2
BASIC ACCOUNTING TERMS

1. **Business Transaction-** A business transaction is an economic activity of the business that changes its financial position. Whenever any business transaction takes place, it results in a change in the values of some of the assets, liabilities or capital.

   Transactions may be (i) Cash Transaction and (ii) Credit Transaction

   (i) Cash Transaction: When the amount of the transaction is paid or received at the time of transaction itself, it is a cash transaction.

   (ii) Credit Transaction: When the amount of transaction is paid or received after the expiry of agreed period of time, it is called a credit transaction.

   Transaction may further be classified as

   (i) External and (ii) Internal

   (i) External Transaction: Transactions between firm and other party are called external transaction e.g., goods sold to Ram, goods bought from Mohan, etc.

   (ii) Internal Transaction: Transactions which does not involve second party are called internal transactions e.g., charging depreciation on plant and machinery, creating provision for doubtful debt on debtors, etc.
2. **Event-** An event is the consequence or result of a transaction.
3. **Account-** In actual practice, the individual transactions of like nature are recorded, added and subtracted at one place. Such place is customarily termed as an 'Account'. Prior to understanding the meaning of debit and credit, it is essential to understand the meaning and from of an Account.

   An account is a record of all business transaction relating to a particular person or item. In accounting we keep a separate record of each individual asset, liability, expenses or income. The place where such a record is maintained is termed as an 'Account'.
4. **Capital**- It refers to the amount invested by the proprietor in a business enterprise. Amount may be in the form of cash, goods or assets. It is the amount with the help of which goods and assets are purchased in the business.
5. **Drawing-** Any cash or value of goods withdrawn by the owner for personal use or any private payments made out of business funds are called drawings.
6. **Liability-** It refers to the amountwhich the firm owes to outsiders (excepting the amount owed to proprietors).

   In the words of ***finney and Miller,*** *"Liabilities are debts, they are amounts owed to Creditors."*

   (i) **Internal Liabilities –** All amounts which a business entity has to pay to the proprietors or owners are internal liabilities such as capital and accumulated profits.

   (ii) **External Liabilities-** All amounts which a business entity has to pay to outsiders are known as external liabilities such as creditors, bank overdraft, loans etc.

   Liabilities may be further classified into two parts as under:-

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(i) **Non- Current Liabilities-** These refer to those liabilities which fall due for payment in a relatively long period (normally after more than one year).For example, Long Term Loans and Debentures etc.

(ii) **Current liabilities –** Current liabilities refer to those liabilities which are to be paid in near future (normally within one year). For example, Bank Overdraft, Bills Payable, Creditors, Outstanding Expenses and Short Term Loans Etc.

7. **Assets-** Anything which is in the possession or is the property of a business enterprise including the amounts due to it from others is called an asset. In other words, anything which will enable a business enterprise to get cash or a benefit in future is an asset. Thus, Cash and Bank balances, Stock, Furniture, Machinery, Land and Building, Bills Receivable, Money owing by Debtors etc. are all assets.

   Assets may be classified into the following categories:

   (i) **Non- Current Assets-** Non- Current Assets refer to those assets which are held for continued use in the business for the purpose of producing goods or services and are meant for sale.

   (a) **Tangible Assets-** Tangible assets are those assets which can be seen and touched. In other words, which have a physical existence such as Land & Building, Plant & Machinery, Computer, Motor Vehicles, Furniture, Stock, Cash etc.

   (b) **Intangible Assets: -** Intangible assets are those assets which do not have a physical existence and thus, cannot be seen or felt. Examples of such assets are Goodwill, Patents, Copyright, Trade Marks, Computer Software and prepaid Expenses. Intangible assets are also valuable assets.

   (ii) **Current Assets:-**Current assets are those assets which are meant for sale or which the management would want to convert into cash within one year. As such, these assets are also termed as Short- lived or active assets.

   (iii) **Fictitious or Nominal Assets:-**These are the Assets which cannot be realized in Cash or no further benefit can be derived from these assets. Such Assets included Debit balance of P & L A/c and the expenditure not yet written off such as Advertisement Expenses ec.

8. **Capital Receipts and Revenue Receipts** – It also necessary to make a proper distinction between capital receipt and revenue receipts because the revenue receipts are shown on the credit side of Trading and Profit & loss Account whereas the capital receipts are shown in the Balance Sheet Either as increase in the liabilities or as reduction in the value of the assets.

   Capital Receipt:

   Example of capital receipts are:

   (i) Amount received from the sale of fixed assets or investments.

   (ii) Capital contributed by proprietors or money obtained from issues of shares and debentures in case of company.

   (iii) Amount received by way of loans.

Revenue Receipts:

(i) Money Obtained from sale of goods.
(ii) Commission and fees received for services rendered.
(iii) Interest and dividend received on investments.

9. **Expenditure-** Any disbursement of cash or transfer of property or incurring a liability for the purpose of acquiring assets, goods or services is called expenditure.

(i) **Capital Expenditure-** Any expenditure which is incurred in acquiring or increasing the value of a fixed asset is termed as capital expenditure.
Such expenditure yields benefit over a long period and hence written in Assets.

(ii) **Revenue Expenditure-**Any expenditure, the full benefit of which is received during one accounting period is termed as revenue expenditure.

Such expenditure does not result in an increase in the earning capacity of the business but only helps in maintaining the existing earning capacity.

Basic		Capital Expenditure	Revenue Expenditure
1.	**Meaning**	Capital expenditures are incurred for acquiring fixed assets like land, building, machinery, computer etc.	Revenue expenditures are incurred for meeting the day to day operations of the business e.g., purchase of goods, payment of wages salary, rent, etc.
2.	**Benefit derived**	They yield benefit over a long period of time (several years)	They yield benefit in the same accounting year.
3.	**Position in Financial Statement**	They are shown as asset in the Balance Sheet	They are debited to Trading A/c or Profit and Loss A/c as per their nature.
4.	**Purpose**	They increase the earning capacity of the business.	They are incurred for the day to day maintenance of the business.

(iii) **Deferred Revenue Expenditure-**There arecertain expenditure which are revenue in nature but the benefit of which is likely to be derived over a number of years. Such expenditures are termed as 'Deferred Revenue Expenditure'. The benefit of such expenditure generally lasts between 3 to 7 years.

10. **Expenses:-**Expenses is the cost incurred in producing and selling the goods and services. According to ***Finney***and ***Miller, "Expenses is the cost of use of things or services for the purpose of generating revenue".***
11. **Income-** 'Income' is the different from 'revenue'. Amount received from sale of goods is called 'Revenue' and the cost of goods sold is called 'Expenses'. Surplus of revenue over expenses is called 'Income'.
12. **Profit-**It is the excess of total revenues over total revenue over total expenses of business enterprises for an account period. Profit increases the investment of the owners.

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13. **Gain-** It is a monetary benefit, profit or advantage resulting from event or transactions which are incidental to business such as sale of fixed Assets, winning a court case or appreciation in the value of an asset.
14. **Loss-** The term conveys two different meanings **first**, It conveys the result of the business for a period when total expenses exceed the total revenue.

    Second, It refers to some fact activity against which firm receives no benefit.
15. **Purchase –** The term purchases is used only for the purchase of 'Goods' in which the business deals. The term purchases includes both cash purchases and credit purchases of goods.

    Purchase Return- When purchased goods are returned to the suppliers these are known as purchase returns. Such returns are also termed as 'returns outward'.
16. **Sales-** Sales means transfer of ownership of goods or services to customers for a price. The term sales includes both Cash and Credit Sales.

    Sales Return- Some customers might return the goods sold to them .These are termed as sales returns or 'return inward'.
17. **Stock or Sock- in –trade –** The stock may be two types:-

    (i) Opening Stock

    (ii) Closing Stock

    The term 'Opening Stock' means the value of goods lying unsold at the beginning of the accounting period whereas the term 'Closing Stock' means the value of goods lying unsold at the end of the accounting period.
18. **Inventory-** In case of manufacturer , there can be opening and closing inventory of four types

    (i) Inventory of Raw Material- It includes inventory of raw materials purchased for using them in the products manufactured but still lying unused.

    (ii) Inventory of Work in Progress- It is also termed as inventory of partly finished goods. It means in semi-finished from. Such goods need further processing for converting into finished products.

    (iii) Inventory of Finished Goods- It includes the inventory of those goods which have been completely processed and are ready for sale but are lying unsold at the end of the accounting period.

    (iv) Inventory of stock in trade- It includes the value of those goods which are purchased for reselling.
19. **Trade Receivables**- Trade receivables refer to the amount receivable on account of sale of goods or services rendered by the company in the normal course of business. Trade receivables include both Debtors and Bills Receivables.

    Debtors- The term 'Debtors' represent those persons or firms to whom goods have been sold or services rendered on credit and payments has not been received from them. They still owe some amount to the business.

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Bill Receivable- A bill of exchange becomes bill receivable for the person who draws it (drawer) and gets it back, after its acceptance from the drawee.

20. **Trade Payables-** Trade payables is the amount payable on account of goods purchased or services taken in the normal course of business.

    Trade Payable include both 'Creditors' and 'Bill Payables'.

    Creditors- The term 'Creditors' represent those persons or firms from whom goods have been purchased or services procured on credit and payment has not been made to them. Some money is still owing to them.

    Bill Payable- A bill of exchange becomes bill payable for the person who accepts it (drawee) and returns it to the drawer.

21. **Goods-** Goods include all those things which are purchased for resale or which are used for producing the finished product which are also meant to be sold.
22. **Cost-** Cost can be termed as the amount of resource given up in exchange for some goods or services. The resources given up are money or money's equivalent expresses in terms of money.
23. **Voucher-** A voucher is a document which provides the authorization to pay and on the basis of which the business transactions are, first of all, recorded in the books of accounts. A separate voucher is prepared for each transaction and it specifies the accounts to be debited or credited.
24. **Discount-** It is a rebate or an allowance given by the seller to the buyer. It is of two types:
    - **(i)** **Trade Discount-** When discount is allowed by a seller to its customers at a fixed percentage on the list or catalogue price of the goods it is called trade discount.
    - **(ii)** **Cash Discount-**When discount is allowed to the customers for making prompt payment it is called cash discount.

      (a) Discount allowed
      (b) Discount received

(a) Discount allowed - If cash discount is allowed to debtors to induce them to make prompt payment, it is called as discount allowed. It is a loss so it is treated as an expense and debited to Profit & Loss Account.

(b) Discount received - If the cash discount is received by the creditors for making prompt payment of goods bought, it is called discount received. Being an income, it is credited to Profit and Loss Account.

25. **Entry-** When a transaction or event is recoded in the books of accounts, it is called 'entry'.
26. **Bad Debts-** It is the amount that has become irrecoverable from a debtor. It is a business loss and is debited to profits & loss Account as an expenses.
27. **Insolvent-** A person or an enterprise which is not in a position to pay its debts is called insolvent.
28. **Solvent-** A person or an enterprise which is in a position to pay its debts is called solvent.
29. **Stores-** The term 'stores' is used to denote materials held by an enterprise for the purpose of consumption in the business and not for resale.

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30. **Revenue-** Revenue in accounting means the income of a recurring (regular) nature from any source. It consists of the amount received from sale of goods and from service provided to customers.

    Revenue is related with the day to day affairs of the business and should also be regular in nature.
31. **Revenue from Operations-** It is the revenue earned by an enterprise from its operating activities. It includes revenue from sale of goods and revenue from sale of services.
32. **Entity-** An entity or business entity means an economic unit which is formed for earning income by providing service or selling goods (for example L.G Electronic, Wipro, Maruti Suzuki etc.
33. **Turnover-** Turnover means total sales made in a particular period.
34. **Livestock-** Domestic animals such as cattle or horses are known as livestock.
35. **Investment-** Investment refers to development of funds in the shares or debentures of Companies with the intention of earning a return.
36. **Proprietor:** Proprietor is a person who makes investment in the business, manages it and is responsible of all risks connected with the business. In accounting, proprietor is considered distinct from the business entity so capital invested by him is considered as internal liability of the business.
37. **Books of Accounts:** The term books of accounts refer to journal and ledger of a business entity in which all the financial transactions are recorded for an accounting period. In large scale business houses where volume of transactions is very large, Journal is further sub-divided into various subsidiary books or books of original entries. These are:
    - **i.** Cash Book
    - **ii.** Purchases Book
    - **iii.** Sales Book
    - **iv.** Purchases Return book
    - **v.** Sales Return Book
    - **vi.** Journal Proper
38. **Entry** -The recording of each transaction in the books of accounts is called an entry. Each transaction should be supported by a voucher (i.e., documentary proof that a transaction has taken place). There should be no entry in the books of accounts without a voucher and there should be no voucher without its entry in the books of accounts.
39. **Debit and Credit**: Ledger contains complete record of all accounts of the business entity during a specified period. Ledger account has two parts, namely (i) Debit and (ii) Credit. The left hand side of ledger is called debit side and the right hand side of ledger is called credit side. Dr. stands for debit and Cr. Stands for credit.

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Ledger
Ram's Account

Dr. **Cr.**

Date	Particulars	J.F	Amount Rs.		Date	Particulars	J.F	Amount Rs.

Debit side Credit side

40. Invoice or Bill: An Invoice or Bill is prepared by the seller of goods when he sells goods to buyer of goods on credit. It is prepared in duplicate. It contains detail like name of the buyer, detail of goods sold, rate, quantity and amount of sales. Original copy of bill is given to the buyer while office copy of invoice is retained by the seller of goods as an evidence of sale for recording the transaction in the books of accounts. It is purchase bill from the point of view of buyer of the goods.

41. Allowance: If some reduction in sales price is given to a customer due to some minor defect in the product, it is called allowance. It is treated similar to discount allowed and discount received.

42. Bad Debts: Bad debt is the amount that has become irrecoverable from the debtor (to whom goods has been sold on credit) due to dispute or insolvency of the debtor. Bad debt is a loss so it is debited to Profit and Loss Account.

43. Solvent: A person or business entity who is in a position to pay its debts in full, is called a solvent.

44. Insolvent: If a person or business entity is not in a position to pay its debts in full, he/it is said to be insolvent. In such cases, the liquidator appointed by court makes (pro-rata) payment to all the unsecured creditors in full settlement of their accounts.

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VERY SHORT ANSWER QUESTION

1. **What is Capital?**
   Ans: It refers to the amount invested by the proprietor in a business enterprise. It can be expressed as: Capital = Asset- External Liabilities
2. **What are Drawing ?**
   Ans: Drawing refer to any Cash or value of goods withdrawn by the owner for personal use.
3. **What are liabilities?**
   Ans : It refers to the amount which the firm owes to outsiders (expecting the amount owed to proprietors
4. **What are Assets?**
   Ans: Assets are valuable recourse own by a business enterprise which can be measured in terms of money.
5. **What are current Assets?**
   Ans : Current Assets include Cash and other assets which are expected to be converted in to cash within a short period (normally within one year)
6. **Give two example of current assets .**
   Ans : (i) Cash ;(ii) Stock
7. **Give two examples of Tangible Assets**
   Ans: (i) Land and Building (ii) Stock
8. **Give two examples of intangible Assets?**
   Ans: (i) Goodwill (ii) Prepaid Expanses
9. **What are fictitious Assets?**
   Ans : These are the Assets which cannot be realised in Cash or no further benefit can be derived from these assets. Such assets include Debit balance of P & L A/c and the expenditure not yet written off such as Advertisement Expenses etc.
10. **What are Current Liabilities ?**
    Ans: Current liabilities refer to those liabilities which are to be paid in near future (normally Within one year).
11. **Give two example of Current Liabilities /**
    Ans. (i|) Creditors (ii) Bills Payable
12. **What are Internal Liabilities ?**
    Ans : All amounts which a business entity has to pay to the proprietor or owners are internal liabilities such as capital and accumulated profits.
13. **What is Expense?**
    Ans: Expanse is the cost incurred in producing and selling the goods and services
14. **What is revenue?**
    AnsRevenue is the income of a recurring (regular) nature such as receipts from sale of goods , rent, commission etc.
15. **What is Income?**
    Ans : Excess of revenue over expense over expenses is called income.
    Income= revenue – expenses.

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16. **What is a voucher ?**

Ans:A voucher is a document in the basis of which transactions are first recorded in the books

17. What is Trade Discount ?

Ans : When discount is allowed by a seller to its customers at fixed percentage on the list or catalogue price of the goods it is called trade discount . It is not recorded in the books accounts.

18. What is Cash Discount ?

Ans: when discount is allowed to the customers for making prompt payment it is called cash discount .it is always recorded in the books of accounts

19. **What is meant by purchases?**

Ans : The term purchase is used for buying of goods for resale or for use in manufacturing process. The term purchases includes both Cash and Credit purchase of goods.

20. **What meant by sales ?**

Ans : the term sales is used for their amount of sales of goods and services rendered . The term sales includes both Cash and credit sales .

21. **Define Merchandise**

Ans Merchandise means good for resale

22. **Profit is earned on sale fixed Assets. What should be the accounting treatment of profit ?**

Ans : It is a capital profit hence it should be transferred to capital reserve.

23. **Give two example of revenue expenditure**

Ans(i) cost of goods sold (ii) salary

<u>OBJECTIVE TYPE QUESTION</u>

1. Fill in the blank :

1. Amount which the proprietor has invested in a business is known as .....
2. Amount which the firm owes to outsider is known as .....
3. .....is the cost incurred in producing goods and service.
4. Revenue means the income of a .....nature .
5. The term 'sales' used only for the sales of ..... and is never used for the sale of .....
6. The persons who still owe some amount to the business are termed as .....
7. The persons to whom money is owing by the firm are termed as .....
8. Assets held for whom money is owing by the business and not meant for resale are termed as .....
9. .....are those assets which have a physical existence and which can be seen felt.
10. ..... refer to those liabilities which are to be paid normally within one year .
11.

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Ans :

1.Capital	2.Liability	3.Expenses
4.Regular or recurring	5.Goods, Assets	6.Debtors
7.Creditors	8.Fixed asset	9.Tangible assets
10.Current liabilities		

3. Classify the following into (i) Assets (ii) Liabilities (iii) Expanses (iv) Revenues

Sales , Bank Balance , Debtors, Bank Overdraft , Creditors , Salary to Manager , Discount to debtors , Cost of goods sold.

Ans.

(i) Assets : Bank balance , Debtors

(ii) Liabilities : Bank Over draft, Creditors

(iii) Expenses: Salary to Managers , Discount to debtors, cost of goods sold

(iv) Revenues: Sales

4. Choose the best Alternate

1. Current Liabilities include :
   - i. Bills Payable
   - ii. Creditor
   - iii. Outstanding Expenses
   - iv. All of the above
2. Which of the following is capital expenditure?
   - i. Wages
   - ii. Wages paid for building construction
   - iii. Repair expenses of building
   - iv. Advertisement expenses
3. A person who owes money to the firm is called.....
   - i. Debtor
   - ii. Creditor
   - iii. Supplier
   - iv. None of the these
4. Goods means:
   - i. Commodity to be bought and sold
   - ii. Commodity to be bought but not to be sold
   - iii. Commodity to used as an asset
   - iv. All of the above
5. Trade discount is :
   - i. Which is allowed at the time of receiving the payment
   - ii. Which is allowed at the time of sale of goods
   - iii. Which is allowed both at the time of receiving payment and sale of goods
   - iv. Allowed in all of the above
6. Cash discount is :

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i. Which is received at the time of making the payment
ii. Which is allowed at the time of sale of goods
iii. Which is received at the time of purchase of goods
iv. Which is received both at the time of making payment and purchase of goods

7. Current assets do not include :
   i. Debtors
   ii. Motor car
   iii. Bank balance
   iv. Prepaid Expenses
8. Tangible assets do not include
   i. Goodwill
   ii. Furniture
   iii. Stock
   iv. Cash
9. Which of the following will be treated as drawing:
   i. Withdrawing money for payment of salary to employees
   ii. Withdrawing money for payment of creditors
   iii. Withdrawing money from business for private expenses
   iv. Withdrawing money for purchase of asset
10. Main feature of business transaction is:
    i. It involves and economic activity
    ii. It results in a change in the financial position of the firm
    iii. Change must be capable of being expressed in terms of money
    iv. All of above
11. Current liabilities do not include :
    i. Bills payable
    ii. Creditors
    iii. Outstanding exp
    iv. Debentures
12. Purchase refers to the buying of
    i. Stationery for office use
    ii. Assets for the factory
    iii. Goods of resale
    iv. Investment
13. The term sales is used only for the sales of .....and is never used for the sale of .....
    i. Assets , investment
    ii. Assets , goods
    iii. Intangible assets, Goods

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iv. Goods , Assets

14. Out of the following assets which one is NOT an intangible asset?
    i. Patents
    ii. Investments
    iii. Goodwill
    iv. Trademark
15. At the end of financial year , during which sale of goods was worth Rs 5,00,000 the closing stock is valued at RS 40, 000 this is...
    i. An event
    ii. A transaction
    iii. Both an event as well as transaction
    iv. None of (a) and(b)
16. Which of the following is the capital expenditure?
    i. Wages paid for repair of building
    ii. Wages paid for white washing of building
    iii. Wages paid for constriction of building
    iv. Wages paid for cleaning of building
17. Consider the following items:

1. Prepaid salary , 2. Accrued interest(Receivable)

3. Loan(short term) 4. Bank overdraft

a. 1, 2, 3, 4
b. 2, 3,4
c. 4 , 3, 1
d. 3, 4

Ans

1(d)	2(b)	3(b)	4(a)	5(b)
6 (a)	7(b)	8(a)	9(c)	10(d)
11(d)	12(c)	13(d)	14(b)	15(c)
16(c)	17(d)			

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