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# CHAPTER 2

# BASIC ACCOUNTING TERM

## BUSINESS TRANSACTION

A business transaction is an economic activity of the business that changes its financial position.

## CHIEF FEATURES OF TRANSACTION

It involves an economic activity.

Transactions are classified into two types- external and internal.

It results in change in financial position of the firm.

The change is being expressed in terms of money.

## ACCOUNTS



An account is a record of all business transactions relating to a particular person or item. In accounting we keep a separate record of each individual, assets, liability, expense or income.

All accounts are divided into two sides. The left side is called debit side and the right side is called credit side

## CAPITAL

It refers to the amount invested by the proprietor in a business. In order to calculate the amount of capital all assets are deducted external liabilities. Capital is also known Owner's equity or Net Worth or Net Assets.

CAPITAL = ASSETS - LIABILITIES

## DRAWINGS

Any cash or value of goods withdrawn by the owner for personal use made out of business funds is called drawings.

## LIABILITY

It refers to the amount which the firm pays to the outsiders.

Liabilities may be divided into two parts:

Internal Liabilities: - The amount which has to pay to the proprietor or owner is internal liabilities.

External liabilities: - The amount which has to pay to the outsiders is known as external liabilities.

## ASSETS

Anything which will enable a business enterprise to get cash or benefit in future is an assets. Thus, all cash and bank balances, stock furniture, machinery, land and building, bill receivables etc are all assets.



## THREE MAIN CHARACTERSTICS OF AN ASSET

The asset must be valuable.

The assets must be owned by the business.

The assets must be acquired as measurable money cost.

## CLASSIFICATION OF ASSETS

**(I) Fixed Assets**: - Fixed assets refers to those assets which are held for continued use in the business for the purpose of producing goods & services and not meant for resale. Example: - land and building, plant & machinery, furniture etc.

**(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. These are also termed as ‘short-lived assets’. Example: - stock, bill receivable, debtor etc.

**(III) Tangible and Intangible Assets**: - Tangible assets are those assets which can be seen and touched. Example: - land, building, furniture, stock etc. Intangible assets are those assets which do not have any physical existence. Example: - patent, know-how etc.

**(IV) Liquid Assets**: - Liquid assets are those which are either in the form of cash or can be quickly converted into cash. Example: - cash, bill receivable, debtors etc.

## CAPITAL RECEIPTS AND REVENUE RECEIPTS

The revenue receipts are shown on the credit side of Trading and Profit & Loss Account. Example: - money obtained from sale of goods, commission and fees received for service rendered, interest and dividend received on investment.

The capital receipts are shown in balance sheet either as increase in liabilities or reduction in the value of assets. Example: - Amount received from sale of fixed assets or investments, Capital contributed by proprietor, Amount received by way of loan.



## EXPENDITURES

## CAPITAL EXPENDITURE

Any expenditure which is incurred in acquiring or increasing the value of a fixed assets is termed as capital expenditure. Such expenditure yields benefit over a long period. Example: - purchase or erection of plant, building etc.

## REVENUE EXPENDITURE

Any expenditure the benefit of which is received during one accounting period. Such expenditure helps in maintaining the existing earning capacity.

## DEFERRED REVENUE EXPENDITURE

There are certain expenditure the benefit of which is likely to be derived over a number of years. Such expenditure is termed as deferred revenue expenditures. The benefit of such assets is generally lasts between 3 to 7 years. The whole of such expenditure is not debited to Profit & Loss Account of the current year but spread over the year for which the benefit is likely to last.

## EXPENSES

"Expenses are the cost of use of things or services for the purpose of generating revenue".

Following are included in the term Expenses-

(i) Cost of revenue from operations.

(ii) Amount paid for rent, commission, salary etc.

(iii) Depreciation



## INCOME

Surplus of revenue over expenses is called 'Income'

**Income = Revenue - Expenses**

## PROFIT

It is excess of total revenues over total expenses of a business enterprise for an accounting period.

## GAIN

It is the monetary benefit resulting from transactions which are incidental to business.

## LOSS

The term conveys two different meanings. First, it conveys the result of the business for period when total expenses exceeds the total revenues. Second, it refers to some activity against which firm receives no benefit.

## PURCHASES

The term purchases are used only for the purchase of 'Goods' in which the business deals.

## PURCHASE RETURNS

When purchased goods are returned to the suppliers these are known as purchase returns. Such returns are also termed as 'returns outward'.



## SALES

The term sales are used for the sales of those goods which are purchased for resale purposes.

### SALES RETURNS

Some customers might return the goods sold to them. Such returns are also termed as 'return inward'.

## STOCK OR INVENTORY

The term 'stock' includes the value of those goods which are lying unsold at the end of accounting period. The stock may be of 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.

## DEBTORS

The Debtor represents those persons or firm to whom goods have been sold or services are rendered on credit and payment has not been received from them.

## ACCOUNT RECEIVABLE

Account Receivable is an amount of money owed by customer for purchase of goods on credit. Account receivables are listed on the balance sheet as current assets.

## CREDITORS

The term creditors represent those person or firms from whom goods have been purchased or services procured on credit and payment has not been made to them.



## ACCOUNT PAYABLES

Account payable is the amounts due to the vendors or suppliers for goods or services rendered that have not yet been paid for. Account Payable will appear on its balance sheet under the current liabilities section.

## DISCOUNT

Discount is the deduction in the price of the goods sold.

It is offered in two ways. Trade discount and Cash discount. Offering deduction of agreed percentage of list price at the time selling goods is one way of giving discount. Such discount is called ‘trade discount’. It is generally offered by manufactures to wholesellers and by wholesellers to retailers.

After selling the goods on credit basis the debtors may be given certain deduction in amount due in case if they pay the amount within the stipulated period or earlier. It is called as cash discount.

**Cash discount acts as an incentive that encourages prompt payment by the debtors.**

## VOUCHER

**The documentary evidence in support of a transaction is known as voucher.**

## GOODS

**It refers to the products in which the business unit is dealing. The items that are purchased for use in the business are not called goods. For example, for a furniture dealer purchase of chairs and tables is termed as goods, while for other it is furniture and is treated as an asset.**