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Module 1

Chapter 3

Accounting Terms

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CHAPTER AT A GLANCE (Chapter – 3)

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3.01 Terms used in Accounting

3.01.01 Debtor is

- a person or firm or company which owes amount to the enterprise on account of **credit sale of goods or services**.
- The amount due from him is a debt.
- The amount due from a person as per the books of the account is called a book debt.

3.01 Terms used in Accounting

3.01.02 Creditor is

- a person or firm or company to whom the enterprise owes amount on account of
- Credit purchase of goods or services.

3.01 Terms used in Accounting

3.01.03 Assets:

- Assets are property or legal rights
- owned by an individual or business
- to which money value can be attached.
- In other words,
- anything which will enable the firm
- to get cash or a benefit in the future,
- is an asset.

3.01 Terms used in Accounting

Assets can be classified as:

- (i) Fixed Assets
- (ii) Current Assets
- (iii) Tangible Assets
- (iv) Intangible Assets
- (v) Wasting Assets

Financial Accounting

3.01 Terms used in Accounting

3.01.04 Liabilities

- Liabilities means the amount
- which the business owes to outsiders,
- that is, excepting the proprietors.

This can be expressed as:

$$\text{Liabilities} = \text{Assets} - \text{Capital}$$

3.01 Terms used in Accounting

Liabilities can be classified in

- (i) Long-Term Liabilities
- (ii) Current Liabilities

3.01 Terms used in Accounting

3.01.05 Goods

- They refer to items
- forming part of the stock-in-trade of an enterprise,
- which are purchased or manufactured
- with a purpose of selling.
- In other words, they refer to the products
- in which an enterprise is dealing.

3.01 Terms used in Accounting

3.01.06 Stock or Inventory

- Stock is the tangible property held by an enterprise
- for the purpose of sale in the ordinary course of business or
- for the purpose of using it in the production of goods
- meant for sale or services to be rendered.
- **Stock may be opening stock or closing stock.**

3.01 Terms used in Accounting

3.01.07 Profit

- Profit is the surplus of revenues of a business
- over its costs.
- ❖ Profit is categorised into:
 - (i) **Gross Profit:** Gross Profit is the difference between sales revenue or the proceeds of goods sold and/or services rendered over its direct cost.
 - (ii) **Net Profit:** Net Profit is the profit made after allowing for all expenses. In case expenses are more than the revenue, it is Net Loss.

3.01 Terms used in Accounting

3.01.08 Loss

- Loss is excess of expenses over its related revenues which may arise from normal business activities.
- It decreases the owner's equity.
- It also refers to money or money's worth lost (or cost incurred) against which the enterprise receives no benefit, e.g., cash or goods lost in theft.
- It also arises from events of non-recurring nature, e.g., loss on sale of fixed assets.

3.01 Terms used in Accounting

3.01.09 Expense

- An expense is the amount spent
- in order to produce and sell the goods and services
- which produce the revenue.
- Expense is the cost of the use of things or services
- for the purpose of generating revenue.
- Expense is that part of the expenditure which has been consumed during the current accounting period.
- Examples of expense are payment of
- salaries, wages, rent, etc.

3.01 Terms used in Accounting

3.01.10 Expenditure:

- An expenditure is the amount spent or liability incurred for the value received.
- An expenditure is a payment (or a money sacrifice) for a benefit received.

3.01 Terms used in Accounting

Expenditure may be categorised into:

- (i) Capital Expenditure
- (ii) Revenue Expenditure

3.01 Terms used in Accounting

(i) Capital Expenditure

It is the amount spent in

- purchasing assets which will give benefit
- over more than one accounting period.
- It means expenditure incurred
- to acquire fixed assets or its improvement.
- Capital expenditure is debited to particular asset account.
- They appear at the assets side of the Balance Sheet.

3.01 Terms used in Accounting

(ii) Revenue Expenditure

It is the amount

- spent to purchase goods and services
- that are consumed during the accounting period.

It is shown in the

- debit side of the Profit and Loss Account.

3.01 Terms used in Accounting

3.01.11 Revenue

It is the gross inflow of

- cash, receivables or other consideration
- arising in the ordinary course of business activities
- from the sale of goods,
- rendering of services, and
- use by others of enterprise resources
- yielding interest, royalties and dividends.

3.01 Terms used in Accounting

Examples of revenue are

- Receipts from sale of goods, rent, commission, etc.

Revenue differs from income.

Income = Revenue – Expense

- Sale of goods and services is revenue and
- cost of sales of goods and services is expense.
- Revenue is an inflow of assets, which results in an increase in the owner's equity

3.01 Terms used in Accounting

3.01.12 Income:

- Income is the profit earned during an accounting period. In other words, the difference between revenue and expense is called income.
- $\text{Income} = \text{Revenue} - \text{Expense}$

3.01 Terms used in Accounting

3.01.13 Transaction

- It is a financial happening entered into by two or more willing parties.
- It effects a change in the asset, liability, or net worth account.
- It is recorded first in journal and then posted in to the ledger

Examples of a transaction are

- sale of goods, purchases of goods, receipt from debtors, payment made to creditors, purchase or sale of fixed assets, payment of dividend, etc.

3.01 Terms used in Accounting

Characteristics of a Transaction

- (i)** It is concerned with money or money's worth of goods or services.
- (ii)** It arises out of the transfer or exchange of goods or services.
- (iii)** It brings a change in the financial position (assets and liabilities) of an entity.
- (iv)** It has dual aspects or sides—'receiving' (Debit) and 'giving' (Credit) of the benefit.
- (v)** Transactions may be cash transaction and credit transaction.

3.01 Terms used in Accounting

Transactions are recorded following the

Business Entity Concept

3.01 Terms used in Accounting

3.01.14 Drawings

- It is the amount of money or the value of goods which the proprietor or a partner takes for his domestic or personal use.
- Drawing reduces the investment (or capital) of the owners.
- It appears only in the accounts of sole proprietorship firms and partnership firms.

3.01 Terms used in Accounting

3.01.15 Capital

It means the amount (in terms of money or assets having money value)

- Which the proprietor has invested in the business
- and can claim from it.
- It is a liability of the business towards the owner.
- It is so because of Business Entity Concept.
- **Capital = Assets – Liabilities**

3.01 Terms used in Accounting

3.01.16 Cost

- It is the amount of expenditure
- incurred on or
- attributable to
- a specified article,
- product or
- activity.

3.01 Terms used in Accounting

3.01.17 Gain

It is a profit that arises from transactions which are incidental to business such as

- sale of investments or fixed assets
- at more than their book values.

- Gain may be operating gain or non-operating gain.

3.01 Terms used in Accounting

3.01.18 Freight

- Freight means the costs for transporting the goods.

3.01 Terms used in Accounting

3.01.19 Purchases

- The term purchases are used only for purchases of goods.

Goods are those items which are purchased

- for resale or for manufacture of products
- which are also to be sold.
- It includes both cash and credit purchases.

3.01 Terms used in Accounting

3.01.20 Purchases Return:

- Goods purchased may be returned due to any reason, say, they are not as per specifications or are defective.
- Goods returned are termed as Purchases Return or Returns Outward.

3.01 Terms used in Accounting

3.01.21 Import

It means goods brought into the country

- from a foreign country
- for the purpose of business.
- Government levies customs duty on goods imported.

3.01 Terms used in Accounting

3.01.22 Freight or Carriage Inwards

It means

- costs incurred for transporting the goods
- to the place of business.
- It is added to purchases cost.

3.01 Terms used in Accounting

3.01.23 Sale

- This term is used for the sale of goods
- dealt by the enterprise.
- The term 'Sales' include both Cash and Credit Sales.
- When goods are sold for cash, they are cash sales
- When goods are sold and payment is to be received at a later date, they are credit sales.

3.01 Terms used in Accounting

3.01.24 Sales Return or Returns Inwards

It means

- Goods sold returned by the purchaser

3.01 Terms used in Accounting

3.01.25 Export

- Export means goods sent out of the country
- Government gives incentives (such as DEPB) on goods exported.

3.01 Terms used in Accounting

3.01.26 Freight or Carriage Outwards

- It is the cost incurred for transporting the goods sold.
- It is part of the selling expenses.

3.01 Terms used in Accounting

3.01.27 Voucher

It is an evidence of a business transaction.

Examples of voucher are:

- Cash Memo, Invoice or Bill, Receipt Debit/Credit Notes, etc.

3.01 Terms used in Accounting

3.01.28 Discount

- A reduction in the price of goods is Discount.

3.01 Terms used in Accounting

3.01.29 Trade Discount

- It is a discount allowed to a customer on the basis of quantity of goods purchased.

3.01 Terms used in Accounting

3.01.30 Cash Discount

It is a discount allowed to a customer for making prompt or timely payment.

3.01 Terms used in Accounting

3.01.31 Account

It is a summarised record of

- relevant transactions at one place
- relating to a particular head.

It records not only the amount of transactions

- but also reflect the direction of the account.

3.01 Terms used in Accounting

3.01.32 Books of Accounts

- They are the records of
- the financial transactions of a business.
- It means Journal, Subsidiary Books and Ledgers in which transactions are recorded.

3.01 Terms used in Accounting

3.01.33 Entry

- A transaction and event when recorded in the books of accounts is known as an Entry.

3.01 Terms used in Accounting

3.01.34 Debit

- An account has two parts; debit and credit.
- The left side is the debit side
- The right side is the credit side.
- If an account is to be debited,
- then the entry is posted to the debit side of the account.
- In such an event, it is said that the account is debited.

3.01 Terms used in Accounting

3.01.35 Credit

Credit is the right side of an account.

- If an account is to be credited,
- then the entry is posted to the credit side of the account.
- In such an event, it is said that the account is credited.

3.01 Terms used in Accounting

3.01.36 Proprietor

is the person who makes

- the investment and
- bears all the risks and rewards of the business

3.01 Terms used in Accounting

3.01.37 Receivables

The term includes the amount due from others.

Example:

- An advance to (say employee) is receivable.

3.01 Terms used in Accounting

3.01.38 Payables

- The term includes the amounts due to others.

Example:

- Amount received for goods to be sold.

3.01 Terms used in Accounting

3.01.39 Bills of Exchange

- It is an unconditional order in writing given by the creditor to the debtor and
- accepted by him (debtor) to pay on demand or
- after certain period,
- a certain sum of money to or
- to the order of a specified person or
- to the bearer.

Financial Accounting

3.01 Terms used in Accounting

3.01.40 Bills Receivable

It means acceptance (Bills of Exchange)

- by a debtor,
- the amount of which will be received
- on the specified date.

3.01 Terms used in Accounting

3.01.41 Bills Payable

It means acceptance (Bills of Exchange)

- the amount of which will be payable on
- the specified date.

3.01 Terms used in Accounting

3.01.42 Depreciation

It is a fall in the value of an asset

- because of usage; or
- with passage of time; or
- obsolescence; or
- accident.

3.01 Terms used in Accounting

3.01.43 Cost of Goods Sold

It is

- direct costs of goods or services sold.

3.01 Terms used in Accounting

3.01.44 Bad Debts

- It is the amount that has become irrecoverable.
- It is a business loss, and
- Thus, is debited to Profit and Loss Account.

3.01 Terms used in Accounting

3.01.45 Insolvent

- Insolvent is a person or an enterprise
- which is not in a position to pay its debts.

3.01 Terms used in Accounting

3.01.46 Solvent

- Solvent is a person or enterprise
- which is in a position to pay its debts.

3.01 Terms used in Accounting

3.01.47 Book Value

- It is the amount at which an item appears
- in the books of accounts.

3.01 Terms used in Accounting

3.01.48 Investments

It means deployment of funds

- with the intention and expectation that
- it will earn a return.
- In common parlance,
- it refers to shares and debentures of companies or
- mutual funds or bonds
- issued by the financial institutions or
- by the Government.
- Investments are not expected to be sold within a year.

3.01 Terms used in Accounting

3.01.49 Entity

- An entity means an economic unit which performs economic activities e.g., Bajaj Auto, Maruti, TISCO.

3.01 Terms used in Accounting

3.01.50 Trial Balance

It is summary of all debit and credit balances at the end of an accounting period that

- shows (if the general ledger has in balance) total debits equals total credits before making closing entries
- serves as a worksheet for making closing entries
- provides the basis for making draft financial statements i.e. Trading, Profit & Loss Account and Balance sheet

3.01 Terms used in Accounting

3.01.51 Trading Account

It is part of an Income Statement

- that shows profit generated by the trading activities of a enterprise called gross profit.
- It includes only direct income and direct expenses of a enterprise

3.01 Terms used in Accounting

3.01.52 Profit and Loss Account

- It is summary of performance of the enterprise in terms of profitability during an accounting period
- It includes the effect of all Income and Expenses of the accounting period whether it is direct or indirect incomes and expenses .

3.01 Terms used in Accounting

3.01.53 Balance Sheet

It is a statement of the financial position

- as at a given date,
- which exhibits its assets, liabilities, capital and reserves
- at their respective book values

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Thank You