CHAPTER 2

IMPORTANT ACCOUNTANT TERMS

Capital – At the time of commencement of business or any time during the financial year, the sum invested in business by the proprietor in the form of cash or bank or goods or any asset or any combination of all then it will be counted as Capital. Capital is also known as Owner's Equity or Net Worth. It is always equal to assets less liabilities. It can be expressed as:

Capital= Assets – Liabilities

(Refer Accounting Equation chapter to know more about this relationship between Assets, liabilities and Capital)

s – Goods include all those things which are purchased for resale or which are used ducing the finished products which are also meant to be sold.

- **Drawings-** It is the amount withdrawn or goods taken by the proprietor for his personal use. Drawings reduce the investment (or capital) of the owners.

- **Purchases –** Goods purchased for resale will be recorded as Purchases instead of using the term goods or stock.

- **Sales –** Goods sold will be recorded as Sales instead of using the term goods or stock.

- **Purchase Return –** Goods purchased are being returned back to our suppliers then it will be recorded as Purchase Return.

- **Sales Return –** Goods sold are being returned back to us from our customers then it will be recorded as Sales Return.

- **Receipts-** Receipts is the amount received or receivable for selling assets, goods or services.

Receipts are of two kinds: capital and revenue.

- **Capital Receipts:** it refers to those receipts that imply an increase in liabilities or a reduction in value of assets. E.g., capital contribution from proprietors, investors, partners; amount received as a loan etc. Capital receipts are reflected in the balance sheet.
- **Revenue Receipts:** those receipts that are obtained through the activities of the business, e.g., proceeds from sale of goods or rendering of services, commission, interest or dividend, etc. Revenue receipts are reflected in the Trading and Profit and Loss Account.

- **Discount –** It is a kind of rebate which is optional to allow for doing a business transaction. It is of two types.

  a. **Trade Discount –** It is given only for promoting business trade. It should not be recorded separately in the books of accounts but the amount of discount will be deducted from the transaction value. It should be given prior to cash discount.

  b. **Cash discount –** It is given for prompt recovery of cash. It should be recorded separately in the books of accounts as it becomes an expense or income for the business.

- **Assets-** Assets is property or legal rights owned by a business to which money value can be attached. Assets are the economic resources for the businesses. In other words, anything which will enable the business to get cash or a benefit in the future and those things are not purchased with intention of resale are called Assets of the business. It can be categorized as –

- **Non- current Assets-** are those assets which are held by a business from a long term point of view. For example long term investments and fixed assets.

  - **Fixed Assets –** Fixed assets are the purchased/constructed assets, used to earn profit not only in current year, but also in next coming years. However, it also depends upon the life and utility of the assets. Fixed assets may be tangible or intangible. Plant & machinery, land & building, furniture, and fixture etc. are the examples of Tangible Fixed Assets whereas Goodwill, Patents, Trademarks, Copyright etc. are examples of Intangible fixed assets.

  - **Current Assets –** The assets are those assets which are held by the business with the purpose of converting them into cash within a short period, i.e. within one year and which are easily available to discharge current liabilities of the firm called as Current Assets. Cash at bank, stock, and sundry debtors are the examples of current assets.

- **Fictitious Assets –** Accumulated losses and expenses, which are not actually any virtual assets called as Fictitious Assets. Discount on issue of shares, Profit & Loss account, and capitalized expenditure for time being are the main examples of fictitious assets.
- **Cash & Cash Equivalents –** Cash balance, cash at bank, Cheque In hand, money in e-wallets and Marketable securities are cumulatively termed as Cash & Cash equivalents.

- **Wasting Assets –** the assets, which are reduce or exhausted in value because of their use are called as Wasting Assets. For example, mines, queries, etc.

- **Tangible Assets –** The assets, which can be touched, seen, and have volume such as cash, stock, building, etc. are called as Tangible Assets.

- **Intangible Assets –** The assets, which are valuable in nature, but cannot be seen, touched, and not have any volume such as patents, goodwill, and trademarks are the important examples of intangible assets.

- **Accounts Receivables –** The bills receivables and sundry debtors come under the category of Accounts Receivables.

- **Working Capital –** Difference between the Current Assets and the Current Liabilities are called as Working Capital.
- **Liabilities-** Liability means amount owed (payable) by the business. Liabilities are the obligation of a business, firm, company arises because of the past transactions or events. Its settlement or repayments are expected to result in an outflow from the resources of respective firm.

There are two major types of Liabilities -

- **Current Liabilities –** The liabilities which are expected to be liquidated or payable by the end of current year or within a year are called as Current Liabilities. For example, taxes, accounts payable, Short term loans, partial payments of long term loans, etc.

- **Non-current Liabilities –** The liabilities which are expected to be liquidated or payable after a period of more than a year are called as Non-current liabilities or Long-term Liabilities. For example, mortgages, long-term loan, long-term bonds, pension obligations, Debenture etc.

- **Debit and Credit-** The word debit is derived from the Latin word *debitum* which means due for that. In short, the benefit receiving aspect of a transaction is known as debit. The word credit is derived from the Latin word *creder* which means due to that. In short, the benefit giving aspect of a transaction is known as credit.

- **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. It means that expenditure is a payment for a benefit received. Expenditure may be capital, revenue or deferred revenue nature.

    1. **Capital Expenditure:** any expenditure incurred for acquiring or increasing the value of fixed asset is termed as capital expenditure. For example, purchase of building, installation of machinery etc.
    2. **Revenue Expenditure:** Any expenditure, whose full benefit is received during the accounting period, is termed as revenue expenditure. It is debited to Trading and Profit & Loss Account. For example, payment of salaries, payment of rent, etc.
    3. **Deferred Revenue Expenditure:** Any expenditure which is basically in the nature of revenue expenditure but whose benefit covers a number of years generally 3 to 7 years, is called deferred revenue expenditure. E.g., heavy advertising expenditure on the launch of new product in the market.

- **Expenses –** it is the amount spent in order to produce and sell the goods and render services. For example, cost of goods sold, purchase of raw materials, payment of salaries, wages, etc. are example of expenses.

  Expenses = Revenue – Income

- **Income –** income is the difference between revenue and expense. Surplus of revenue over expenses is called Income.

  Income = Revenue – Expenses

- **Profit –** a profit refers to the net return received by a business upon undertaking an activity and meeting all operating expenses during its performance.

- **Gains –** It is monetary benefit, profit or advantage resulting from a business transaction or group of transactions. For example, if a machinery costing ₹8,00,000 sold for ₹8,50,000; ₹50,000 will be the gain on sale of machinery. Gain may be either of capital nature or revenue nature or both.

- **Losses –** loss means something against which the firm receives no benefit. This term conveys two different meanings. Firstly, it conveys the results of the business for a period when expenses exceed the revenue. For example, if revenue are ₹ 3,00,000 and expenses are ₹ 3,40,000, then the loss will be ₹ 40,000.

  Secondly, it refers to some fact, or activities against which firm receives no benefits. For example, loss due to fire or theft or accident, etc. It may be noted losses and expenses are different items.

- **Stock (Stock-in-trade) –** stock includes value of those goods which are purchased for reselling and which are lying unsold on a particular date. Stock may be opening stock and closing stock. The term opening stock means goods lying unsold in the beginning of the accounting period. Whereas the term closing stock includes goods lying unsold at the end of the accounting period. For example, if 4,000 units purchased at ₹20 per unit remain unsold at the end of the year, the closing stock is ₹ 80,000. This will be opening stock of the subsequent year.

- **Inventory –** in a manufacturing business, a wider term inventory is used which includes stock also. There can be opening and closing inventory of four types-

  (i) Inventory of raw material.

  (ii) Inventory of work-in-progress/semi-finished goods.

  (iii) Inventory of finished goods.

  (iv) Inventory of stock-in-trade.

  It is important to know that inventory is valued on the basis of cost or net realizable value (market value) whichever is lower.

- **Debtors –** a person (individual or firm) who receives a benefit without giving money or money's worth immediately, but liable to pay in future or in due course of time is a debtor. The debtors are shown as an asset in the balance sheet. For example, Mr. Atul bought goods on credit from Mr. Basu for ₹ 10,000. Mr. Atul is a debtor to Mr. Basu till he pays the value of the goods to Mr. Basu. Debtors are the assets for the business.

- **Bills Receivable –** bills receivable is Bill of exchange in the hand of a person who has a legal right to receive the amount due on it from the concerned person on whom it is written. In other words, the bill of exchange is known as Bills receivable for the creditor.

- **Trade Payables –** it refer to the amount due on account of goods purchased or services received in the normal course of business which must be settled within 12 months. Sundry creditors and bills payables are jointly called as "Trade Payables".

- **Creditors –** a person who gives a benefit without receiving money or money's worth immediately but to claim in future is a creditor. The creditors are shown as a liability in the balance sheet. In the above example, Mr. Basu is a creditor to Mr. Atul till he received the value of the goods.

- **Bills Payable –** Bills Payable refer to a bill of exchange for a person who is liable to pay it on its maturity. In other words, the bill of exchange is known as Bill payable for the debtor.

- **Cost –** cost of anything is generally understood as a sum that is paid or foregone to acquire it. In business, cost is the cumulative monetary valuation of effort, material, resources, time and utilities, risk incurred, and opportunity foregone in production or delivery of goods or services or any activity undertaken for business purposes.

- **Voucher –** it is a written document in support of a transaction. It is a proof of a particular transaction that has taken place for the value stated in the voucher. It may be in the form of cash receipt, invoice, cash memo, bank pay-in-slip, etc. A separate voucher is prepared for every transaction and each voucher is numbered. Voucher is necessary to audit the accounts.

- **Turnover –** total amount of goods sold during a definite time period which includes cash as well as credit sales is called Turnover. It is also named as total sales.

- **Insolvent –** One who is not able to pay his liabilities in full and is declared insolvent by the court is called an insolvent. In such a case, the assets of a businessman are less than his liabilities.

- **Revenue –** it means the amount receivable or realized from sale of goods and services provided to a customer in day-to-day affairs of the business. It should be regular in nature. It also includes earnings from interest, dividend, commission, etc., which increases the owner's capital and assets of the business. Revenue differs from income. Sale of goods and rendering services is revenue and cost of goods sold and services are expense. The difference between revenue and expense is income. It can be expressed as follows:

  Income = Revenue - Expense

Bases of Accounting

There are two types of bases of accounts- Cash basis and accrual or mercantile basis.

1. Cash basis- Cash basis of accounting is a system in which transactions are recorded when cash is received or paid i.e. entry is not recorded when a payment or receipt is merely due. it means revenue is recognized on receipt of cash. Likewise, expenses are recorded as incurred when they have been paid. The difference between the total income and total expenses represents profit or loss of a business for the accounting period. Thus, when cash basis of accounting is followed, outstanding and prepaid expenses and income received in advance or accrued incomes are not considered. Receipts and payment account prepared in case of Not-for-profit-organizations, such as charitable institutions, clubs and schools, is an example of accounting on cash basis.

   Outstanding expenses- Those expenses which have become due during the accounting period but which have not been paid are known as outstanding expenses.

   Prepaid expenses- Those expenses which have been paid in advance are known as prepaid expenses.

   Accrued income- it is an income which has been earned during the accounting period but has not yet become due and, therefore, has not been received.

   Income received in advance- It6 is an income which has been received before it has been earned i.e., goods have been sold or services have been rendered.

   Example 1- During the financial year2012-13 , Ashok had cash sales of Rs. 390000 and credit sales of rs. 160000. His expenses for the year were rs.270000 out of which Rs. 80000 is still to be paid. Find out Ashok's incomefor 2012-13 following the cash basis of accounting.

   Solution- Revenues (inflow of cash i.e., cash sales) = 390000
   (Less): Expenses (outflow of cash) (Rs.270000-80000) = (190000_
   Net income = 200000

   Note- credit sales and outstanding expenses will not be considered under cash basis of accounting.

2. Accrual basis of accounting
   (Refer to accrual assumption or concept in the topic 'Important Accounting Principles and concepts' discussed in this chapter above.