

Basic Accounting Terminologies

A Simple and short explanation of most frequently used terminology in accountancy

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Objectives

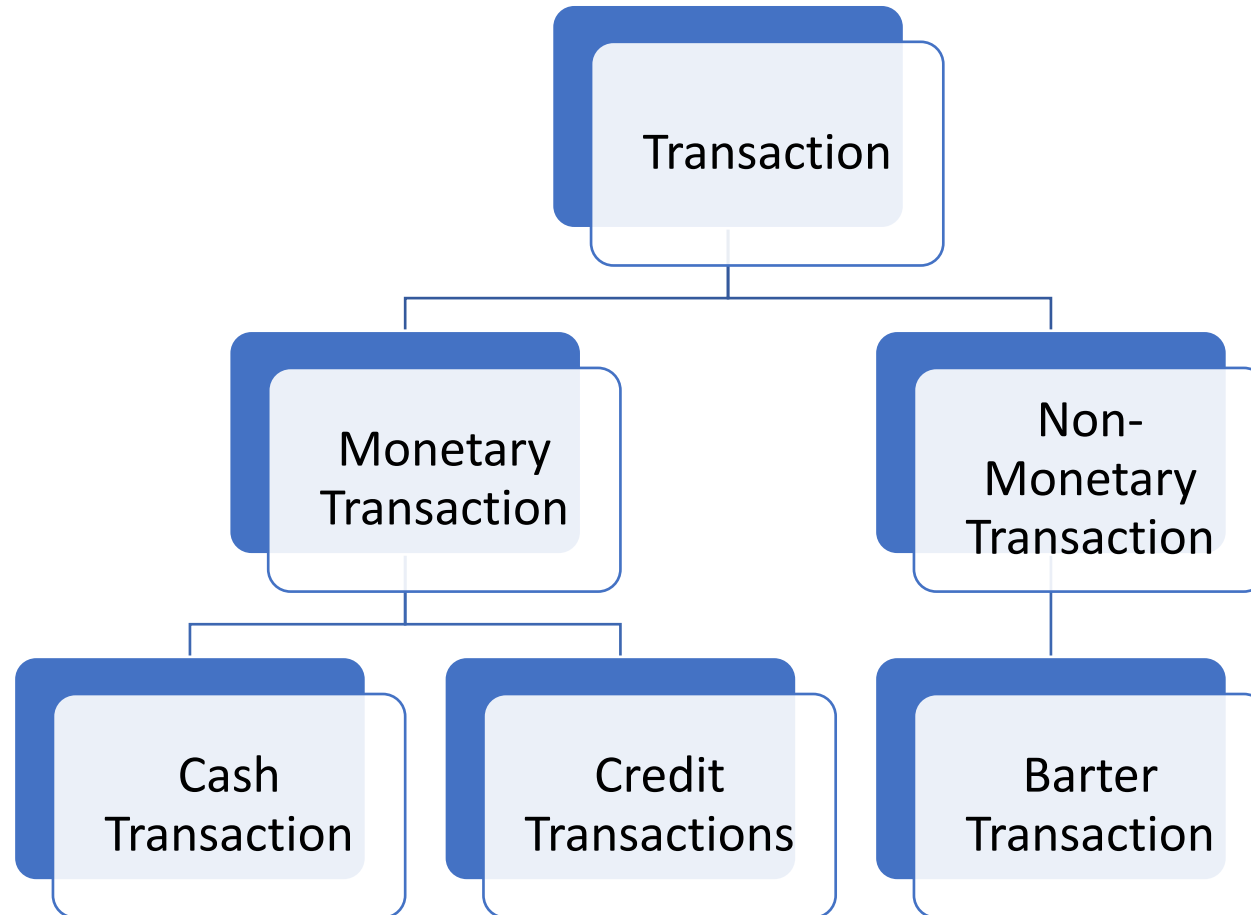
Basic Accounting Terms

- Terms here stands for the vocabulary used in accounting practice and making records.
- It is essential to understand these terms before understanding accounting.
- It is vital system which is used by the modern business world.
- There are many terminologies used in accountancy .
- There are as follows:

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- There are as follows:

1) Transaction



Business Transaction

- Economic activity which changes financial condition of business.
- Exchange of goods & services between two person or parties for money or money's worth is called as Transaction
- This change must be measurable in Monetary terms .
- It can be of two types : 1)Monetary transaction.
2) Non- Monetary Transastion

Monetary Transaction

- The transaction which involve an exchange of money or money's worth , directly or indirectly are called monetary transaction .
- Only monetary transaction are recorded in book of accounts.
- These can be further classified into two type : 1) Cash Transaction
2) Credit Transaction

Non- Monetary Transaction

The transaction which does not involve an exchange of money or money's worth directly or indirectly are called Non-monetary transactions.

An exchange of one thing against another thing is called as Barter transactions.

2) Entry

Recording of a business transaction in the proper form or method in the books of accounts is called an entry.

3) Narration

A brief explanation of the business transaction for which an entry is passed is called as a narration.

- It is always given in a bracket below the journal entry and it usually starts with the word "Being" or "For".

4) Goods

The term 'goods' refers to merchandise, commodities, articles or things in which a trader trades. These are purchased or manufactured for the purpose of sale and to earn profit.

e.g i) Medicines are goods for the chemist.

ii) Vegetables are goods for the vegetable vendor.

iii) Parts like tyres, engine gearbox, cables are produced by a vehicle manufacturerlike Bajaj Auto, Hero Motors.

5) Capital

- The total amount invested into the business by the owner is called capital.
- Excess of assets over the liabilities is also called as capital. The equation for this is :

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

- Capital is a liability of the business as this amount is payable by the business enterprise to the owner at the time of closure of the business.

Eg: A businessman requires rs 5,00,000 to buy the machinery and stock of goods for running the business . He will raise the money by taking a bank loan and by putting his own money. He has taken loan of rs 2,00,000 and balances rs 3,00,000 is the money that he has put in.

Here Assets =rs 5,00,000 ; Liabilities = rs 2,00,000

$$\begin{aligned}\text{Capital} &= \text{Assets} - \text{Liabilities} \\ &= 5,00,000 - 2,00,000\end{aligned}$$

$$\text{Capital} = \text{rs } 3,00,000$$

6) Drawing

- The amount of cash or value of goods, assets, etc., withdrawn from the business by the owner for personal use called as drawings.

E.g. : A proprietor pays colleges fees of his son, or pays for his medical expenses, mobile bills etc, from the business.

7) Debtor & Creditor

- a) **Debtor** : A person who has to pay to the business for getting goods and services on credit is known as debtor. A debtor is a person who owes money to the business.
- b) **Creditor**: A person to whom business has to pay for getting goods or services on credit is known as creditor. A creditor is a person to whom business owes money.
- c) **Bad Debts** : An irrecoverable amount from a debtor is known as "Bad Debts". It is a revenue loss to the business.

8) Expenditure & Type of Expenditure

- **Expenditure:** An amount spent by the business for any consideration received by business is called expenditure.

i) Capital Expenditure : This expenditure is incurred to acquire fixed asset or to increase the value of fixed asset. It gives the benefit for a long period of time and it is non-recurring in nature.

E.g. : Purchase of Machinery, extension of building, purchase of computer etc.

ii) Revenue Expenditure : Revenue expenditure is an expenditure from which no future benefit is expected but having immediate or short term benefit may be less than one year. It does not increase profit earning capacity of an organization. These are normal day to day operating expenses of a business organization and appear on the debit side of Trading A/c or Profit and Loss A/c.

E.g. : Rent paid, Salary paid, Wages paid etc.

iii) Deferred Revenue Expenditure: An expenditure which is basically revenue in nature but benefit of which is not exhausted within one year is called as Deferred Revenue Expenditure. Such expenditure is written off over number of years. Such written off amount is shown on debit side of profit and loss a/c and unwritten amount is shown on asset side of the Balance Sheet.

E.g. : Heavy expenditure on advertising , heavy legal expenses.

9) Cash Discount & Trade Discount

Discount is a concession or allowance given by the seller to purchaser.

There are two types of discounts.

i) Trade Discount : It is an allowance given on catalogue price or list price of goods. This discount is allowed at the time of purchase/sale of goods. Value of goods purchased/sold recorded is net value payable i.e after deduction of amount of trade discount allowed. If goods of ` 1000/- are sold at 5% trade discount, the value of goods that will be recorded will be ` 950/- both by the purchaser and the seller and not ` 1000/-. Hence, trade discount does not appear in the books of accounts separately.

ii) Cash Discount: It is the amount deducted from the final amount due at the time of receipt. It is the concession given for encouraging prompt payment. It is given either for the spot payment or for payment within a specific period. Cash discount is calculated after deducting trade discount, since it is loss to the seller and gain to the buyer, cash discount appears in the books of accounts.

10) Solvent & Insolvent

i) Solvent: If a person's assets are more than his liabilities, or equal to his liabilities, he is called as a solvent person. Solvent person is financially sound and is in a position to pay off all his debts.

E.g. : A person's total assets have been calculated to ` 50,00,000/- and his total debts were 30,00,000/- since his position is sound he is able to pay off his debts therefore he is called Solvent.

ii) Insolvent: A person whose liabilities are more than his assets is an insolvent person. Such person's liabilities are more than his assets.

E.g. : A person's total assets or property have been calculated to ` 20,00,000/- and his total debts were ` 50,00,000/- and if he is not in a position to get any amount from any sources and if the court is so satisfied then he will be declared as an insolvent person.

11) Accounting Year

- It is the period of 12 months for which accounts are maintained and closed by the proprietor.
- Earlier the proprietors were following any accounting year i.e. calendar year , or financial year or any other year as per tradition.
- But now for income tax purpose an accounting year starts on 1st April and end on 31st March. At the end of accounting year a proprietor has to prepare Trading account, Profit and Loss account and Balance Sheet to find out the financial position of the business.

12) Concern & Not for Profit Concern

i) Trading Concern: A business concern established with an object of earning profit by selling goods is known as Trading concern. It is also called as commercial organization or profit making organization.

ii) Not for Profit Concern: It is an organization not established for making profit but for rendering services to the society. An organization may be formed for promoting a useful object like science, sports, culture, charity, profession etc.

e.g Schools, Hospitals, Sports Club etc.

13) Goodwill

Goodwill may be described as the aggregate of those intangible attributes of a business which contributes to its superior earning capacity over a normal return on investment. It may arise from such attributes as favorable locations, the ability and skill of its employees and management, quality of its products and services, customer satisfaction etc.

- Goodwill is the reputation of business expressed in terms of money.
- Goodwill is an intangible asset

14) Profit & loss, Income & Revenue

a) Profit : When the selling price of goods is more than the cost price it is a profit. Profit increases the capital of the business.

e.g. If goods are sold for ` 50,000/- and all expenses during the period amounted to 30,000/- then the profit is ` 20,000/-

b) Loss : When cost price of goods is more than its selling price it is a loss. Loss decreases the capital of business

e.g If goods are sold for ` 50,000/- and all expenses during the period amounted 60,000/, then the loss will be ` 10,000/-

c) Income: It is revenue arising as a result of business transactions. It is the amount receivable or realised from services provided and earnings from interest, dividend, commission, etc.

d) Revenue: It is income that a business has from its normal business activities usually from the sale of goods and services to customer.

15) Assets, Liabilities & Net worth

i) Assets : Any physical thing or right owned that has a monetary value is called as an asset. The ownership of the Asset must be with business unit. E.g Land, Goodwill, Patents, Computers etc.

Types of Assets:

a) Fixed Assets/Non current Assets : The assets which give long term benefit to the business are known as fixed assets

e.g Land and Building, Plant & Machinery, Goodwill etc. These assets may be tangible or intangible.

b) Current Assets : Assets which are held in the business for the operating year and can be converted into cash very easily are called as current assets.

e.g Debtors, Bills Receivable Cash in Hand, Cash at Bank, Stock etc.

c) Fictitious Assets : These assets are not represented by tangible possession or property. They are imaginary assets but do not have any realisable value.

e.g Deferred revenue expense like advertisement paid for 4 years.

iii) Liabilities: Amount payable by the business to others is known as liability. It is a debt or amount due from the business to others for the benefit received by the business unit. e.g Loan taken, Creditors, Bank Overdraft, Outstanding Expenses etc.

Types of Liabilities:

a) Fixed Liabilities : One of the major source of funds in the business is fixed liabilities. It may be in the form of capital, secured loans, long term loans from banks and from financial institutions etc.

b) Current Liabilities: Short term liabilities payable within a year are called current liabilities. Current liabilities arise in the regular current operations of the business. These liabilities are not normally secured. E.g. Creditors, Bills Payable etc.

iv) Net worth or Owners Equity or Capital:

The amount or funds provided by the proprietor in the business is called as “Capital” as well as the excess of assets over liabilities of the business is also known as “Capital” or “Net Worth”.Net worth includes Capital and Reserves. Capital can be in the form of cash or in kind.

$$\text{Net worth} = \text{Owner's Equity} = \text{Capital}$$

• OR

$$\text{Owner's Equity (Capital)} = \text{Total Equity(Assets)} - \text{Creditors Equity(Liabilities)}$$

16) Contingent Liabilities

- **Contingent Liabilities:**

A liability which may arise in future depends on happening or non-happening of certain event is called as contingent liability. As it is not confirmed or perfect liability, it does not affect the financial position of the business and therefore, it is not shown on the liability side of the Balance Sheet. But it is shown by way of foot note to Balance Sheet simply as information.

e.g. A worker makes a claim for compensation of ` 5,000/- against the business and the decision is pending in the court. It may be a future liability for business on happening of an event i.e “Court Verdict”

Thank you