BASIC ACCOUNTING TERM-2

Business Transactions

- It involves an economic activity. Eg. goods purchased for cash, interest paid on loan etc. social activities are not considered as transactions.
- It results in a change in financial position of the firm- change in the assets, liabilities or Capital.
- The change must be capable of being expressed in terms of money.. Eg. Loss due to death of efficient employee may be quite large, but since it cannot be measured in terms of money, it will not be recorded a business transactions .
- Transactions may be classified as follows:

  Cash Transactions and Credit transactions

Event

- An event is the consequence or result of a transactions.

Transactions are:

Investment in the business {Capital} 5,00,000

purchase of Goods.

sale of Goods , Rent paid etc.

Events are :

profit or loss due to sale and purchase .

closing stock at the end of the year

change in capital due to profit or loss.

Account

- An account is a record of all business transactions relating to a particular person or item.eg. Purchase account, sales account, salary account, rent account, Amit`s account.
- All account are divided into two sides. The left side of an account is called Debit side and right side of an account is called credit side.

Debit side is written as Dr and Credit side is written as Cr.

Format of Account

Capital

- It refers to the amount invested by proprietor (owner) in a business enterprises. Amount may be in the form of cash, goods or assets.

  Capital = Assets –Liabilities.
- Capital is also known as Owner's Equity or Net worth or Net Assets.
- Capital is also known as Internal Liability.

Liabilities

Meaning : It refers to the amount which the firm owes to outsider (excepting the amount owed to proprietors).

Liabilities = Assets –Capital

Eg. when a firm purchase goods on credit from A, the amount owing to A is a liability. A is known as creditor.

Eg. When a bank account is over drawn, the amount owing to the bank is known as liability (Bank overdraft).

Bills payable, creditors, unpaid rent are also the examples of liabilities.

Types Of Liabilities

On the basis of Users	On the basis of Time
Internal Liabilities All amount which a business entity has to pay to the proprietor or owner Are internal liabilities such as capital and profits. **External Liabilities** All amount which a business entity has to pay to the outsiders are know as external liabilities such as creditors, Bank overdraft, loan etc.	**Non Current Liabilities** Those liabilities which fall due for payment in a long period(more than one year).Eg long term loans. **Current Liabilities** Those liabilities which are to be paid in near future (with in a year).For example, Bank overdraft, bills payable, Creditors, outstanding expenses and short terms loans

ASSETS (own)

Meaning : Anything which is in the possession or is the property of a business enterprises including the amount due to it from others, is called an asset.

Examples: Stock, Machinery, Land, building, Bills receivable, Money owing (cash and Bank), Furniture, Debtor(Money owing from persons) are all assets.

Assets includes :

1. The resources must be valuable.
2. The resource must be owned by the business.
3. The Resource must be acquired at a measureable money cost.

Types of Assets

1. Non Current Assets

2. Current Assets

3. Fictitious Assets

Non Current Assets

It refers to those assets which are held for continued use in the business for the purpose for producing goods or services and are not meant for sale. Eg : Building, machinery, Goodwill

Types of Non Current Assets

1. Long Term Investment (in shares and debentures)
2. Fixed Assets :These assets are classified as follows

(a) Tangible Assets : Assets which can be seen and touched or which have a physical existence such as land & building , plant & machinery , computer, Motor vehicles , Furniture etc.

Note : Assets which provide long term benefit(i.e more than 1 year)

Intangible Assets : Those assets which do not have a physical existence and thus can not be seen or felt. Examples : Goodwill , Patents, copyright, Trade mark, Computer software and pre paid expenses.(current assets)

CURRENT ASSETS

Those assets which are meant for sale or which the management would want to convert into cash with one year. Examples Stock, Debtors, Bills Receivable, prepaid expenses, Bank, cash in hand and short term investment

Current assets are also known as floating assets as the amount nature of such assets keeps changing continuously.

Fictitious Assets

Assets which can not be realised in cash or no further benefit can be derived from these assets .These assets are not really assets but are shown on the assets side.

Examples: Debit balance of Profit and loss a/c

Advertisement expenditure not yet written off.

Capital Receipts and Revenue Receipts

Capital Receipts

- Amount received from sale of fixed assets or investments.(1,00,00,000)
- Capital contribution by proprietors , partners or money received from issue of shares.
- Amount received by way of loans.

Note : capital receipts are shown in the balance sheet
Either as increase in liabilities or as Reduction in the value of assets.

Revenue Receipts

- Money obtained from sale of goods
- Commission and fees received for services provided
- Interest and dividend received on investment

Note : Revenue receipts are shown in profit and loss account .

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.

or

Any type of payment for the receipt of a benefit is expenditure.

Examples: Purchase of fixed assets.

purchase of goods or service

payment of expenses such as salary, rent , electricity advertisement, insurance , interest etc.

Expenditure may be classified into three categories.

Types of Expenditures

Capital Expenditure	Revenue Expenditure	Deferred Revenue Expenditure
Any expenditure incurred In acquiring or increasing the value of fixed assets is known as capital expenditure. eg,. Purchase of building, machinery, furniture etc such expenditure yield benefit over a long period. capital expenditure as an assets and recorded in balance sheet.	Any expenditure, the full benefit of which is received during one accounting period is termed as revenue expenditure. Eg: Purchase of goods, rent paid, salary paid etc. Such expenses only help in maintaining the existing earning capacity. It shown in trading and profit and loss account.	Certain expenditure Which are revenue in nature but the benefit of which is likely to be derived over a number of years. Such expenditures are known as Deferred revenue expenditure. The benefit of such Expenditure between 3 to 7 years.

EXPENSES

Expenses is the cost incurred in producing and selling the goods and services..

Following are included in the term expenses.

1. Cost of goods sold. (materials, wages, direct expenses)
2. Amount paid for Rent, commission, salary etc.
3. Decline in the value of an asset caused by the use of such asset for business purpose (eg Depreciation)

INCOME-PROFIT-GAIN

INCOME- Total earning of the business which includes both earned from normal business activities or any other business activity not undertaken by business regularly.

PROFIT- Means income earned by the business from it normal operating activities.(sale of goods or rendering services)

Gross profit	Net profit
Difference between enterprises revenue and it direct cost Direct cost means purchase and expenses related to purchase.	Difference between total revenue and total expenses. Total expenses means direct cost and indirect cost.

Gain : It is a monetary benefit ,profit or advantage from events or transactions which are incidental to business such as sale of fixed asset, or winning a court case etc,

GOODS: are the physical item of trade, **the items in which the firm deal, purchased/produced to be sold.**

Goods
"Purchase"

CASH

CREDIT

Goods
"Sale"

CASH

CREDIT

Purchase-Sale-Purchase return-Sale return

PURCHASE , **means the goods bought for resale /raw material for producing finished goods to be sold. EG :** Purchase of stationery.

SALE, means the sale of goods in which the firm deals in. Sale of stationery.

PURCHASE RETURN/ RETURN OUTWARD, goods purchased may be return to the seller on account of defect may be. Purchase of stationery retuned due to defect

SALES RETURN/ RETURN INWARD, goods sold if returned by the customer.

STOCK :

Amount of goods/ tangible assets held by a firm for sale/ using it in producing goods for sale.

Stock may be divided into three categories on the basis of nature

- Stock of Raw Materials
- Stock of semi finished goods
- stock of finished goods

Stock is shown in the balance sheet as CURRENT ASSETS,

Valued at cost price or market price whichever is less.

Other Important Terms

DEBTOR, an amount to the firm on account of sale of goods to him owes on credit.

BILLS RECEIVABLE, a bill of exchange accepted by the DEBTOR , the amount of which will be received on the date specified on the bill.

TRADE RECEIVEABLE= DEBTORS + B/R

CREDITOR, to whom the firm owes an amount on account of goods purchased from him on credit.

BILLS PAYABLE A bill of exchange accepted by a person/ firm, the amount of which will be received on the date specified.

TRADE PAYABLES= CREDITORS+ B/P

BAD DEBTS the amount owed to the firm which has become irrecoverable, loss to the firm, Debited to Profit and Loss A/c.

Discount

Reduction in the price of goods is known as discount.

TRADE DISCOUNT

1. Reduction in prices by the seller when purchaser buy goods of certain quantity.
2. Sales / Purchases are recorded at SALES/ PURCHASES- TRADE DISCOUNT.
3. Trade discount is Not recorded in the books of Accounts.

CASH DISCOUNT

1. When discount allowed for timely payment of amount due.
2. Recorded in the books of accounts.
3. Expense for the party allowing the discount, income for the party receiving the discount.

Voucher : A document which provides the evidence to record transactions in the primary book of account

eg: Cheque , Invoice , pay in slip, debit note , credit note.

Insolvent : A person or enterprises which is not in position to pay its debts (liabilities) is called insolvent.

Stores : It is used to denote materials held by an enterprises for the purpose of consumption in the business and not for resale. Examples: lubricants, spare parts of machinery, packing materials.

Drawings

(Amount withdrawn by the Owner for personal use.)

In the form of CASH or

In the form of GOODS, at Purchase Cost.

[DEBITED TO DRAWINGS A/c]

In balance Sheet, Minus from CAPITAL

Revenue : Income of a recurring (regular) nature from any source. Amount received from sale of goods or services provided to customers.

It also includes receipts of Rent, commission , interest etc.

Turnover: Total sales made in a particular period.

Livestock : Animals such as cattle or horses used in the business are known as Live stock. It is an asset of the business.

Investment: It refers to deployment of funds in the shares or other securities of companies with the intention of earning a return.

Financial Statements

Statements which are prepared at the end of accounting year are known as financial statements.

Theses statements are also known as Final Accounts.

Financial Statements	It presents	Results
Trading Account	Financial performance	Gross Profit
Profit and Loss Account (Income statement)	Financial performance	Net Profit(Total revenue –total cost)
Balance Sheet (Statement of position)	Financial Position	Total Assets = capital + Liabilities