CHAPTER 1

Introduction to Accounting

(Meaning and Objectives of Accounting and Accounting Information)

LEARNING OBJECTIVES

This Chapter would enable you to understand:

- Meaning and Definitions of Accounting
- Attributes (Characteristics) of Accounting
- Objectives of Accounting
- Functions of Accounting
- Advantages of Accounting
- Limitations of Accounting
- Role of Accounting in Business
- Accounting Process
- Branches of Accounting
- Book Keeping, Accounting and Accountancy
- Accounting Information and its Types
- Qualitative Characteristics of Accounting Information
- Users of Accounting Information
- Systems of Accounting

MEANING AND DEFINITIONS OF ACCOUNTING

Accounting is a systematic process of identifying, measuring, recording, classifying, summarising, interpreting and communicating financial information to the users. It gives information on:

(*i*) the resources available;
(*ii*) how the available resources have been employed; and
(*iii*) the results achieved by their use.

It shows the profit earned or loss incurred during the accounting period, value and nature of assets, liabilities and owners' equity, *i.e.*, capital.

Since accounting is a medium of communication, it is called the **language of business**.

"Accounting is the art of recording, classifying and summarising in a significant manner and in terms of money; transactions and events which are, in part at least, of a financial character, and interpreting the results thereof."

—American Institute of Certified Public Accountants

"*Accounting is the science of recording and classifying business transactions and events, primarily of a financial character, and the art of making significant summaries, analysis and interpretations of those transactions and events and communicating the results to persons who must make decisions or form judgment.*"

—Smith and Ashburne

"Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information."

—American Accounting Association

ATTRIBUTES (CHARACTERISTICS) OF ACCOUNTING

The definitions of accounting bring to light the following characteristics of accounting:

1. Identification of Financial Transactions and Events: Accounting records only those transactions and events which can be measured in terms of money. This involves identifying transactions and events that are part of economic activity, for example, purchase of raw material or sale of finished goods by a firm. Such transactions are identified with the help of bills and receipts as evidence of the transactions.

2. Measuring the Identified Transactions: Accounting measures the transactions and events in terms of a common measurement unit (that is the currency of a country). In other words, *financial transactions and events are measured in terms of money*.

Note: *An event which cannot be measured in terms of money is not recorded in the books of account. For example, event like the calibre or quality of management team or appointment of a manager are not recorded in the books of account.*

3. Recording: Accounting is an art of recording business transactions in the books of account. Recording is the process of recording business transactions of financial character in the book of original entry, *i.e.*, Journal. This book is further sub-divided into subsidiary books such as Cash Journal or Cash Book (for recording cash transactions), Purchases Journal or Purchases Book (for recording credit purchases of goods), Sales Journal or Sales Book (for recording credit sales), etc.

4. Classifying: Classification is the process of grouping transactions or entries of one nature at one place. The transactions recorded in the 'Journal' or the subsidiary books are classified or posted to the main book of account known as the **Ledger**. This book contains individual account heads under which all financial transactions of a similar nature are collected. For example, in Rahul's Account in the Ledger, all business transactions related to Rahul are posted so that what is ultimately due to Rahul or due from Rahul can be ascertained.

5. Summarising: This involves presenting the classified data in a manner which is understandable and useful for internal as well as external users of accounting statements. This process leads to the preparation of the following statements:

(*i*) Trial Balance,

(*ii*) Trading and Profit and Loss Account or Statement of Profit and Loss (in case of Companies) and

(*iii*) Balance Sheet.

The above statements are collectively known as **Final Accounts** or **Financial Statements**.

6. Analysis and Interpretation: Analysis and interpretation of the financial data are carried out so that the users of financial data can make a meaningful judgement of the profitability and financial position of the business. This helps in planning for the future in a better way.

7. Communicating: Finally, the accounting function involves communicating the financial data, *i.e.*, financial statements, to its users. The accounting information must be provided in time and presented to the users so that appropriate decisions may be taken at the right time.

OBJECTIVES OF ACCOUNTING

The objectives of accounting are:

1. Maintaining Accounting Records: The objective of accounting is to record financial transactions and events of the organisation in the books of account in a systematic manner following the principles of accountancy.

2. Determining Profit or Loss: Another objective of accounting is to determine the net result of transactions for a period. In other words, to determine whether during the accounting period, the firm has earned a profit or incurred a loss. For this purpose, a statement called an **Income Statement** or the **Trading and Profit and Loss Account** is prepared. Revenues resulting from the transactions of the period are recorded in the credit and expenses in the debit. The difference between the two sides is either profit or loss.

3. Determining Financial Position: Another objective of accounting is to determine financial position. It is known from the Balance Sheet. Financial position of the business is as relevant for the users of financial statements as is the Income Statement, *i.e.*, Profit and Loss Account (Statement of Profit and Loss, in the case of Companies).

4. Facilitating Management: The management often requires financial information for decision-making, effective control, budgeting and forecasting. Accounting provides financial information to assist the management in discharging this function.

5. Providing Accounting Information to Users: Yet another objective of accounting is to provide accounting information to users, both internal and external, who analyse them as per their needs.

6. Protecting Business Assets: Another objective of accounting is to have records of assets owned by the business. Accounting maintains record of assets owned by the business which enables the management to protect them and exercise control.

FUNCTIONS OF ACCOUNTING

1. Maintaining Systematic Accounting Records: The primary function of accounting is to maintain systematic accounting records of financial transactions and events. It means that the accounting records should be maintained following the accounting rules, principles and concepts. It is so because reliable financial statements can be drawn if proper accounting records are maintained.

2. Preparation of Financial Statements: Financial statements means final accounts prepared at the end of the accounting period. It includes Income Statement (Profit and Loss Account) and Position Statement (Balance Sheet). It is an important function of accounting because the financial statements show the financial performance, *i.e.*, profit earned or loss incurred during the accounting year and the financial position, *i.e.*, Balance Sheet as at the end of the accounting year. Both the statements are important for all the users for taking decisions.

3. Meeting Legal Requirements: Accounting records are accepted as evidence by the court of law if they are maintained systematically following the accounting rules, principles and concepts. Besides, the law such as the Companies Act, Income Tax Act, GST Act, etc., require submissions of returns in the form and period as is prescribed in the law. The returns can be submitted if the accounting records are maintained systematically and timely. A systematic accounting record maintained following the accounting principles and concepts is accepted by the authorities to be correct. Thus, it is a function of accounting to meet the legal requirements.

4. Communicating the Financial Information: It is yet another function of accounting to communicate the financial information to the users, which may be internal users or external users, such as management, banks, employees, government authorities, etc.

5. Assistance to Management: Management often requires financial information which is given by the accounting records which in turn helps the management in decision-making. Accounting record should be maintained in such a manner that the assets owned are known. It will assist the management in protecting the assets and also exercising control.

ADVANTAGES OF ACCOUNTING

1. Financial Information about Business: Financial performance during the accounting period, *i.e.*, profit earned or loss incurred and also the financial position at the end of the accounting period is known through accounting.

2. Assistance to Management: The management makes business plans, takes decisions and exercises control over the affairs on the basis of accounting information.

3. Replaces Memory: A systematic and timely recording of transactions obviates the necessity to remember transactions. The accounting record provides the necessary information.

4. Facilitates Comparative Study: A systematic record enables a businessman to compare one year's results with those of other years and locate significant factors leading to change, if any.

5. Facilitates Settlement of Tax Liabilities: A systematic accounting record immensely helps in settlement of income tax and Goods and Services Tax (GST) liabilities, since it is a good evidence of the correctness of transactions.

6. Facilitates Loans: Loan is granted by the banks and financial institutions on the basis of growth potential which is supported by the performance. Accounting makes available the information with respect to performance.

7. Evidence in Court: Systematic record of transactions is often accepted by the Courts as good evidence.

8. Facilitates Sale of Business: If someone desires to sell his business, the accounts maintained by him will enable the ascertainment of the proper purchase price.

9. Assistance in the Event of Insolvency: Insolvency proceedings involve explaining many transactions that have taken place in the past. Systematic accounting records assist a great deal in such situation.

10. Helpful in Partnership Accounts: At the time of admission or retirement or death of a partner or in case of dissolution of the firm, the accounting record is of vital importance and use because it provides the basis to reach a settlement.

11. Helpful in Decision-making: Accounting helps in taking a large number of decisions like the amount to be withdrawn by proprietor, the price at which goods should be sold, etc.

LIMITATIONS OF ACCOUNTING

1. Accounting is not Fully Exact: Accounting is not fully exact in spite of the fact that most transactions are recorded on the basis of evidence, yet some estimates are also made for ascertaining profit or loss, for examples, estimating the useful life of an asset, providing for doubtful debts, net realisable value of closing stock, etc.

2. Unrealistic Information: Accounting information may not be realistic since accounting statements are prepared following the accounting concepts and conventions. For example, under the Going Concern Concept, it is taken that business will continue for a foreseeable future. Accordingly, assets are recorded at cost and depreciated over their useful life. The assets may not be actually realisable at book value.

3. Accounting Ignores the Qualitative Elements: Accounting is confined to monetary matters only, therefore, qualitative elements like quality or skills of management and staff, industrial relations and public relations are ignored.

4. Accounting Ignores the Effect of Price Level Changes: Accounting statements are prepared at historical cost. Money, as a measurement unit, changes in value frequently, *i.e.*, it does not remain stable. Accounting, however, presumes that value of money remains stable. Unless price level changes are considered, accounting information will not show correct financial results.

5. Accounting May Lead to Window Dressing: The term window dressing means manipulation of accounts in a way so as to conceal vital facts and present the financial statements to show a better position than what it actually is. In this situation, income statement (*i.e.*, Profit and Loss Account) fails to provide a true and fair view of the result of operations and the Balance Sheet fails to provide a true and fair view of the financial position of the enterprise.

ROLE OF ACCOUNTING IN BUSINESS

Accounting is a process of identifying, measuring, recording, classifying, summarising, analysing, interpreting and communicating the financial transaction of a business in a useful manner.

Following points highlight the role of accounting in the field of business:

1. Maintenance of Systematic Records: The primary role of accounting is to maintain systematic records of financial transactions in order to ascertain the net profit or loss for the accounting period and financial position of the business as on a particular date.

2. Assistance to Management: Accounting provides assistance to management by providing financial information for its effective functioning and taking rational decisions.

3. Facilitates Comparative Study: A systematic record of financial transactions enables a businessman to compare one year's results with those of other years and locate significant reasons leading to change, if any.

4. Evidence in Court: Accounting records are often accepted by courts as good evidence.

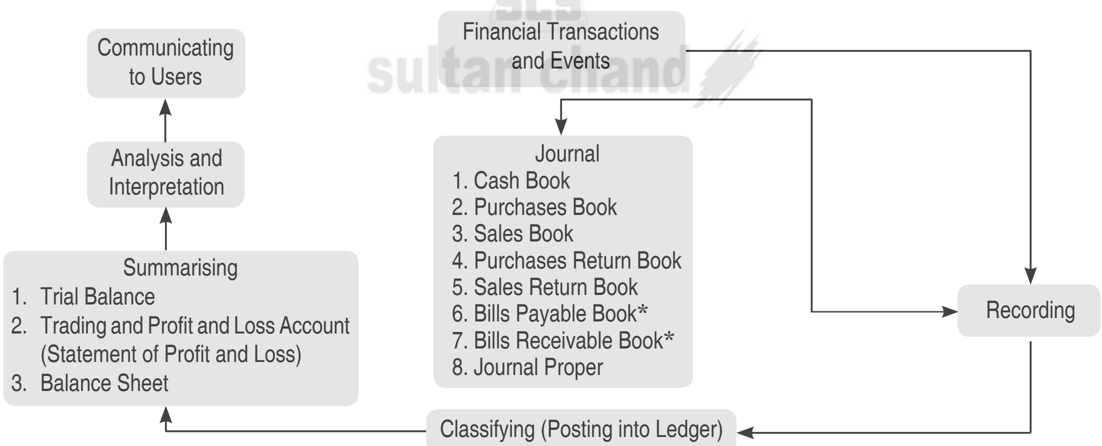
5. Others:

(*i*) Proper accounting records obviates the necessity to remember business transactions.
(*ii*) Facilitiates Raising Loans.
(*iii*) Facilitates sale of Business by ascertaining the proper purchase price.
(*iv*) Facilitates settlement of tax liabilities.

ACCOUNTING PROCESS

Based on the attributes of accounting, the steps of accounting process are as follows: (*i*) Identifying Financial Transactions and Events, (*ii*) Recording, (*iii*) Classifying, (*iv*) Summarising, (*v*) Analysing and Interpreting and (*vi*) Communicating. The accounting process may be explained with the help of a diagram:

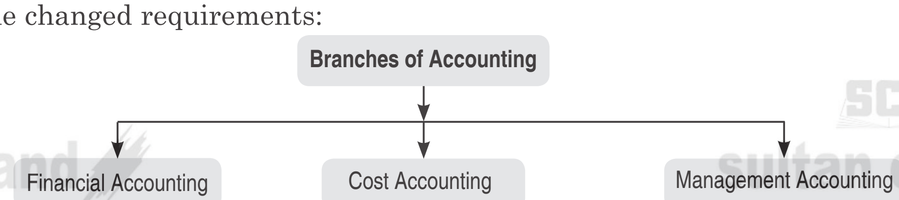
Accounting Process



*Not in Syllabus.

BRANCHES OF ACCOUNTING

With the changing times, following specialised branches of accounting have emerged to meet the changed requirements:



Financial Accounting

Financial Accounting is that branch of accounting which records financial transactions and events, summarises and interprets them before communicating the results to the users. It determines profit earned or loss incurred during an accounting period (usually a year) and the financial position on the date when the accounting period ends. The end-product of financial accounting is the Profit and Loss Account for the period ended (which shows the profit earned or loss incurred) and the Balance Sheet as on the last day of the accounting period (which shows the financial position).

In short, financial accounting is confined to the preparation of financial statements, *i.e.*, the Profit and Loss Account and the Balance Sheet, for the users of accounting information.

Cost Accounting

This branch of accounting is concerned with ascertaining cost of products, operations, processes or activities. It is that branch of accounting which deals with recording costs with the objective of ascertaining, reducing and controlling costs.

Management Accounting

Management Accounting is the most recently developed branch of accounting. It is concerned with generating accounting information relating to funds, costs, profits, etc., as it enables the management in decision-making. We may say that Management Accounting addresses the needs of a single user group, *i.e.,* the management.

BOOK KEEPING, ACCOUNTING AND ACCOUNTANCY

The terms 'Book Keeping' and 'Accounting', often considered as same is not correct. The two terms are different from each other. Accounting is a wider concept and includes Book Keeping.

Meaning of Book Keeping

Book Keeping is a part of accounting being a process of recording financial transactions and events in the books of account. Thus, Book Keeping involves:

1. Identifying financial transactions and events,
2. Measuring them in terms of money,
3. Recording the identified financial transactions and events in the books of account, and
4. Classifying recorded transactions and events, *i.e.*, posting them into Ledger accounts.

Definitions of Book Keeping

"*Book Keeping is an art of recording in the books of account the monetary aspect of commercial and financial transactions.*" **—Northcott**

"*Book Keeping is an art of recording business dealings in a set of books.*" **—J.R. Batliboi**

"*Book Keeping is the science and art of recording correctly in the books of account all those business transactions that result in the transfer of money or money's worth.*" —**R.N. Carter**

"*Book Keeping is the art of recording business transactions in a systematic manner.*"
—**A.N. Rosen Kampff**

Accounting

Accounting is a wider concept than Book Keeping. It starts where Book Keeping ends. In other words, Book Keeping is a part of accounting.

Difference between Book Keeping and Accounting

Basis	Book Keeping	Accounting
1. **Scope**	Book Keeping is concerned with identifying financial transactions and events; measuring them in money terms; recording them in the books of account and classifying them.	Accounting is concerned with summarising the recorded transactions and events, interpreting them and communicating the results thereof.
2. **Stage**	It is a primary stage. It is the basis for accounting.	It is a secondary stage. It begins where Book Keeping ends.
3. **Objective**	The objective of Book Keeping is to maintain systematic records of financial transactions.	The objective of Accounting is to ascertain net results of operations and financial position and to communicate information to the interested parties.
4. **Nature of Job**	This job is routine in nature.	This job is analytical and dynamic in nature.
5. **Performance**	It being a routine work is performed by junior staff.	It being a specialised function is performed by senior staff.
6. **Special Skills**	Book Keeping is mechanical in nature and, thus, does not require special skills.	Accounting requires special skills and ability to analyse and interpret.

Accountancy

Accountancy is a systematic knowledge of accounting. It explains how to deal with various aspects of accounting. It educates us how to maintain the books of account and how to summarise the accounting information and communicate it to the users. In the words of **Kohler**, *accountancy refers to the entire body of the theory and practice of accounting*.

Accounting and Accountancy

Accountancy is knowledge whereas accounting is the action or process. Accounting process is carried out on the basis of the rules and principles framed by accountancy. Thus, it may be said that accountancy is knowledge of accounting and accounting is the application of accountancy.

ACCOUNTING INFORMATION

"*Accounting is a service activity. Its function is to provide qualitative information, primarily financial in nature, about economic entities that is intended to be useful in making economic decisions.*" —**Accounting Principles Board**

As an information system, accounting collects financial data, records it in the books of account, classifies and summarises it to produce financial information that is communicated to its users. Accounting begins with the identification of transactions of financial nature and ends with the preparation of financial statements (*i.e.*, Income Statement and Balance Sheet). Each step in the process of accounting generates information. Generation of information is not an end in itself, it is a way to facilitate the communication of information to users of accounting information.

Types of Accounting Information

Accounting information refers to the financial statements generated through the process of Book Keeping, use of which helps the users to arrive at decisions. The financial statements so generated are the Income Statement, *i.e.*, Profit and Loss Account and the Position Statement, *i.e.*, Balance Sheet. The information made available by these statements can be categorised into the following:

1. Information Relating to Profit or Surplus;
2. Information Relating to Financial Position; and
3. Information about Cash Flow.

Let us now discuss these in detail.

1. Information Relating to Profit or Surplus: The Income Statement makes available the accounting information about the profit earned or loss incurred as a result of business operations or otherwise during an accounting period.

A firm prepares Trading Account, a part of the Profit and Loss Account, which provides information about Gross Profit or Gross Loss and Profit and Loss Account provides information about the Net Profit or Net Loss.

2. Information Relating to Financial Position: The Position Statement, *i.e.,* the Balance Sheet makes available the information about the financial position of the entity. The Position Statement provides information about the assets owned by the entity, amounts receivable and the cash and bank balances held by it. These are represented in the liabilities by the amounts owed by the entity towards loans, creditors and amounts payable, and capital.

3. Information about Cash Flow: Cash Flow Statement is a statement that shows flow, both inflow and outflow, of cash during a specific period. It is of immense use as many decisions such as payment of liabilities, payment of dividend and expansion of business, etc., are based on availability of cash.

QUALITATIVE CHARACTERISTICS OF ACCOUNTING INFORMATION

Qualitative characteristics are attributes that make the accounting information useful to users. The qualitative characteristics are:

1. Reliability: Accounting information must be reliable. Reliability of information means it is verifiable, free from bias and material error.

2. Relevance: Accounting information must be relevant to the user. Information is relevant if it meets the needs of the users in decision-making.

3. Understandability: Understandability means that the information provided through the financial statements must be presented in a manner that the users are able to understand it.

4. Comparability: Comparability means that the users should be able to compare the accounting information of an enterprise of the period either with that of other periods, known as **intra-firm comparison** or with the accounting information of other enterprises, known as **inter-firm comparison**.

USERS OF ACCOUNTING INFORMATION

Users of Accounting Information may be categorised into Internal Users and External Users.

Internal Users

(*i*) ***Owners:*** Owners contribute capital in the business and thus are exposed to maximum risk. Naturally, they are interested in knowing the profit earned or loss incurred by the business besides the safety of their capital. The financial statements give the information about profit or loss and financial position of the business.

(*ii*) ***Management:*** The management makes extensive use of accounting information to arrive at informed decisions such as determination of selling price, cost controls and reduction, investment into new projects, etc.

(*iii*) ***Employees and Workers:*** Employees and workers are entitled to bonus at the year-end, which is linked to the profit earned by an enterprise. Therefore, the employees and workers are interested in financial statements. Besides, the financial statements also reflect whether the enterprise has deposited its dues towards Employees' Provident Fund and Employees' State Insurance, etc., or not with the appropriate authorities.

External Users

(*i*) ***Banks and Financial Institutions:*** Banks and financial institutions are an essential part of any business as they provide loans to businesses. Naturally, they watch the performance of the business to know whether it is making progress as projected to ensure the safety and recovery of the loan advanced and payment of interest. They assess it by analysing the accounting information.

(*ii*) ***Investors and Potential Investors:*** Investment involves risk and also the investors do not have direct control over the business affairs. Therefore, they rely on the accounting information available to them and seek answers to questions such as—what is the earning capacity of the enterprise and how safe is their investment?

(*iii*) ***Creditors:*** Creditors are those parties who supply goods and/or services on credit. It is a common business practice that a large number of suppliers remain invested in credit sales. Before granting credit, creditors satisfy themselves about the credit-worthiness of the business. The financial statements help them immensely in making such an assessment.

(*iv*) ***Government and its Authorities:*** The government makes use of financial statements to compile national income accounts and other information. The information available to it enables it to take policy decisions.

Government levies varied taxes such as custom duty, GST and income tax. These government authorities assess correct tax dues after an analysis of the financial statements.

(*v*) ***Researchers:*** Researchers use accounting information in their research work.

(*vi*) ***Consumers:*** Consumers require accounting information for establishing good accounting control so that cost of production may be reduced with the resultant reduction in the prices of products they buy. Sometimes, prices of some products are fixed by the government, so it needs accounting information to fix fair prices so that consumers and producers are not exploited.

(*vii*) ***Public:*** They want to see the business running since it makes substantial contribution to the economy in many ways, *e.g.*, employment of people, patronage to suppliers, etc. Thus, financial accounting provides useful financial information to various user groups for decision-making.

IS ACCOUNTING AN ART OR A SCIENCE?

Accounting is an Art as well as a Science. Art is the technique which helps us to achieve our desired objectives. Accounting is an art of recording, classifying and summarising financial transactions. It helps us in knowing the profitability and financial position of the business.

Any organised knowledge based on certain basic principles is a 'science'. Accounting is also a science as it is an organised knowledge based on certain basic principles.

SYSTEMS OF ACCOUNTING

The systems of recording transactions in the books of account are two namely:

1. Double Entry System, and
2. Single Entry System.

1. Double Entry System

Double Entry System of accounting is a system of accounting under which both, debit and credit, aspects of accounting are recorded. A transaction has two aspects—Debit and Credit—and at the time of recording a transaction, one aspect is recorded on the debit side and other aspect is recorded on the credit side. For example, at the time of cash purchases, goods are received and in return cash is paid. In the transaction, two aspects are involved, *i.e.*, receiving goods and paying cash and under the Double Entry System, both these aspects are recorded. One part, *i.e.*, the receipt of goods, is debited and the second part, *i.e.*, payment of cash, is credited. In other words, if only two accounts are affected (as in the purchase of building for cash), one account, Building, is debited and the other account, Cash, is credited for the same amount. If more than two accounts are affected by a transaction, the sum of the debit entries must be equal to the sum of the credit entries. Thus, on any day, total amount debited is equal to the total amount credited.

Thus, we can define Double Entry System as: "*The system which recognises and records both aspects of a transaction. The Double Entry System has proved to be a scientific and complete system of accounting.*"

Features of the Double Entry System

1. It maintains a complete record of each transaction.
2. It recognises two-fold aspect of every transaction, *viz.*, the aspect of receiving (value in) and the aspect of giving (value out).
3. In this system, one aspect is debited and the other aspect is credited following the rules of debit and credit.
4. Since one aspect of a transaction is debited and the other is credited, the total of all debits is always equal to total of all credits. It helps in establishing arithmetical accuracy by preparing the Trial Balance.

Stages of Double Entry System

A complete system of double entry book keeping has following three stages:

1. Recording the transactions in the Journal.
2. Classifying transactions in the Journal by posting them to the appropriate ledger accounts and then preparing the Trial Balance.
3. Closing the books and preparing the final accounts.

All these stages shall be discussed one by one in succeeding chapters.

Advantages of the Double Entry System

The advantages of Double Entry System are:

(*i*) ***Scientific System:*** Double Entry System is a scientific system of recording business transactions as compared to other systems of Book Keeping. It helps attain the objectives of accounting.

(*ii*) ***Complete Record of Transactions:*** Under the system, both sides of a transaction are recorded. It is a complete record as it results in showing correct income or loss, assets and liabilities.

(*iii*) ***Arithmetical Accuracy of Accounts is Ensured:*** By the use of this system, arithmetical accuracy of the accounting work can be established through the Trial Balance.

(*iv*) ***Determining Profit or Loss:*** Profit earned or loss incurred during a period can be determined by preparing Profit and Loss Account.

(*v*) ***Knowledge of Financial Position:*** Financial position of the firm or the institution can be ascertained at the end of each period by preparing the Balance Sheet.

(*vi*) ***Full Details for Purposes of Control:*** The system permits accounts to be maintained in as much detail as necessary and, therefore, provides significant information for purposes of control, etc.

(*vii*) ***Comparative Study is Possible:*** Results of one year may be compared with those of previous years and reasons for the change may be ascertained.

(*viii*) ***Helps Management in Decision-making:*** Management may be able to obtain good information for its work, especially in making decisions.

(ix) ***Detection of Frauds and Misappropriations:*** Frauds and misappropriations are minimised since complete information about all assets and liabilities is available.

It is because of these advantages that the Double Entry System is used extensively in all countries.

2. Accounts from Incomplete Records or Single Entry System

Account from Incomplete Records or Single Entry System of recording transactions in the books of account may be defined as an incomplete Double Entry System. In this system, all transactions are not recorded on double entry basis. In some transactions, both aspects of the transactions are recorded, while in others, either one aspect is recorded or not recorded at all. Instead of maintaining all the accounts, only Personal Accounts and Cash Book are maintained under this system. The accounts maintained under this system are incomplete and unsystematic and, therefore, not reliable.

Since all transactions are not recorded under this system on double entry basis, it is not possible to prepare a Trial Balance. As a result, the Profit and Loss Account and the Balance Sheet cannot be prepared.

QUESTIONS

Higher Order Thinking Skills (HOTS) Questions

Q. 1. Accounting records transactions and events that can be measured in money terms. Is this, in your opinion, a limitation of accounting or an advantage? Give reasons.

Ans. Yes. Accounting records only financial transactions and events. It is an advantage as transactions of diverse nature are recorded using a common yardstick, *i.e.*, money. But there are other important transactions and events which may have far-reaching effect on business. They are not recorded because they cannot be measured in money terms. For example, production loss due to labour strike. Thus, it is a limitation to that extent.

Q. 2. Resignation by a Marketing Manager is not recorded in the books of account. Why?

Ans. It is not recorded because it cannot be measured in money terms.

Q. 3. Book Keeping is not a part of accounting. Do you agree with the statement?

Ans. No. Book Keeping is a part of accounting. Two processes of accounting, *i.e.*, collecting and recording of financial transactions and events are the processes of Book Keeping.

Q. 4. Is the basic objective of Book Keeping to maintain systematic records or to ascertain net results of operations of financial transactions? (*MSE Chandigarh 2011*)

Ans. The basic objective of Book Keeping is to maintain systematic records of financial transactions.

Q. 5. Recording the transactions and events correctly and preparing financial statements are the only objectives of accounting. Do you agree?

Ans. No. Besides recording them correctly and preparing financial statements, accounting has the objectives of facilitating management control and communicating financial information to the users.

Q. 6. Which type of accounting information shows profit earned or loss incurred?

Ans. Profit and Loss Account (in case of firms) and Statement of Profit and Loss (in case of Companies) shows profit earned or loss incurred during the accounting period.

Q. 7. State whether the following statements are **True** or **False** with reason:

(*i*) Accounting may be influenced by the personal judgment.

(*ii*) Financial Statements are not comparable.

(*iii*) Accounting Information must be presented in such a way that only accounting people understand it.

(*iv*) Accounting Information must be reliable.

Ans. (*i*) *True:* Accountant has to exercise his personal judgment in respect of various items such as estimating useful life of an asset to charge depreciation.

(*ii*) *False:* Financial Statements of two or more years are comparable or of different firms in the same industry if they adopt the same accounting policies year to year.

(*iii*) *False:* Accounting Information must be presented in a simple and logical manner that they are understood easily by the users.

(*iv*) *True:* Accounting Information must be reliable, *i.e.*, the information must be factual and verifiable.

Multiple Choice Questions (MCQs)

Select the correct alternative:

(*i*) Book Keeping and Accounting

(*a*) means same and are used interchangeably.

(*b*) does not mean same and are not used interchangeably.

(*c*) means both (*a*) and (*b*).

(*d*) None of the above.

(*ii*) Accounting

(*a*) includes Book Keeping. (*b*) does not include Book Keeping.

(*c*) may or may not include Book Keeping. (*d*) None of these.

(*iii*) Which of the following will not be recorded in the books of account?

(*a*) Sales of goods (*b*) Payment of salary

(*c*) Quality of staff (*d*) Purchase of Goods

(*iv*) Book Keeping is concerned with

(*a*) recording financial data relating to business operations.

(*b*) designing for systems recording, classifying and summarising recorded data.

(*c*) interpreting data for internal and external users.

(*d*) All of the above.

(*v*) Which is the last step of accounting as a process of information?

(*a*) Recording the transaction

(*b*) Preparation of financial statements

(*c*) Communication of information

(*d*) Analysis and interpretation of information

(*vi*) Basic function of financial accounting is to
- (*a*) record all business transactions.
- (*b*) interpret financial data.
- (*c*) assist the management.
- (*d*) None of these.

(*vii*) Transactions are posted into Ledger Account from
- (*a*) Vouchers.
- (*b*) Journal book.
- (*c*) Bank Statement.
- (*d*) None of these.

(*viii*) Which of the following is not a business transaction?
- (*a*) Purchase of goods for resale amounted to ₹ 50,000
- (*b*) Paid salaries and wages amounted to ₹ 10,000
- (*c*) Paid rent for office premises ₹ 5,000
- (*d*) Purchased a LCD for personal use

(*ix*) Which of the following transactions will not be recorded in the books of account?
- (*a*) Purchased a LCD for personal use, paying the amount from personal bank account.
- (*b*) Purchased machinery for manufacture.
- (*c*) Purchased machinery for resale.
- (*d*) Paid salaries and wages.

(*x*) Accounting does not show the realisable value of business. It is a/an
- (*a*) limitation of Accounting.
- (*b*) advantage of Accounting.
- (*c*) Both (*a*) and (*b*).
- (*d*) None of these.

(*xi*) Which of the following is not an internal user of financial statements?
- (*a*) Board of Directors
- (*b*) Managers
- (*c*) Employees
- (*d*) Lenders

(*xii*) Which of the following is not a characteristic of accounting?
- (*a*) Recording non-monetary transactions
- (*b*) Classifying
- (*c*) Analysis
- (*d*) Summarising

(*xiii*) Which of the following is a limitation of accounting?
- (*a*) Assistance to Management
- (*b*) Replaces Memory
- (*c*) Unrealistic Information
- (*d*) Evidence in Court

(*xiv*) Cost of Goods Manufactured is determined by
- (*a*) Financial Accounting.
- (*b*) Cost Accounting.
- (*c*) Management Accounting.
- (*d*) Human Resource Accounting.

(*xv*) Qualitative characteristic of Accounting includes
- (*a*) Reliability and Relevance.
- (*b*) Understandability and Comparability.
- (*c*) Both (*a*) and (*b*).
- (*d*) None of the above.

(*xvi*) Which of the following is not a qualitative characteristic of accounting information?
- (*a*) Reliability
- (*b*) Understandability
- (*c*) Comparability
- (*d*) Materiality

(*xvii*) Which qualitative characteristic of accounting information is reflected when accounting information is clearly presented?

(*a*) Reliability (*b*) Relevance

(*c*) Comparability (*d*) Understandability

(*xviii*) Which external user of accounting information is most interested in knowing the long-term solvency position of the firm?

(*a*) Employees (*b*) Management

(*c*) Bank and Financial Institutions (*d*) Researchers

[(*i*) (*b*); (*ii*) (*a*); (*iii*) (*c*); (*iv*) (*a*); (*v*) (*c*); (*vi*) (*a*); (*vii*) (*b*); (*viii*) (*d*); (*ix*) (*a*); (*x*) (*a*); (*xi*) (*d*): (*xii*) (*a*); (*xiii*) (*c*); (*xiv*) (*b*); (*xv*) (*c*); (*xvi*) (*d*); (*xvii*) (*d*); (*xviii*) (*c*).]

Very Short Answer Type Questions

Q. 1. Give the meaning of 'Accounting'. (*Delhi 2011*)

Ans. Accounting is a process of identifying financial transactions, measuring them in money terms, recording them in primary books, classifying, summarising, analysing, interpreting them and communicating the results to the users.

Q. 2. List **any two** functions of Accounting.

Ans. Two functions of accounting are:

(*i*) Identifying financial transactions; and (*ii*) Recording them in the books of account.

Q. 3. What are the steps involved in the process of accounting?

Ans. The steps involved in the process of accounting are:

(*i*) Identifying financial transactions and events;

(*ii*) Recording in the books of account;

(*iii*) Classifying the recorded entries;

(*iv*) Preparation of Trial Balance;

(*v*) Preparation of Final Accounts;

(*vi*) Analysis and Interpretation of Financial Statements; and

(*vii*) Communicating to the users.

Q. 4. Name the branch of commerce, which keeps a record of monetary transactions in a set of books. (*MSE Chandigarh 2009*)

Ans. Book Keeping.

Q. 5. Define Book Keeping.

Ans. Book Keeping is an art of recording in the books of account the monetary aspect of commercial and financial transactions.

Q. 6. What is the function of Book Keeping?

Ans. The function of Book Keeping is to identify financial transactions and events, measuring them in money terms, recording them in the books of account and classifying the recorded transactions.

Q. 7. Name **any two** objectives of Accounting. (*KVS 2010*)

Ans. The two objectives of Accounting are:

(*i*) Ascertaining profit or loss; and (*ii*) Ascertaining financial position.

Q. 8. What are the advantages of Accounting? **(Any Two)**

Ans. Two advantages of Accounting are:

(*i*) Financial performance and position is known; and

(*ii*) Assist management in making business plans, take decisions and exercise control.

Q. 9. What are the limitations of Accounting? **(Any Two)** (*Delhi 2008, KVS 2010*)

Ans. The limitations of Accounting are:

(*i*) Non-financial informations are not recorded; and

(*ii*) It ignores price level changes.

Q. 10. Name **any one** external user of Accounting information. (*Delhi 2009*)

Ans. Creditors.

Q. 11. What are the **two** accounting systems to record financial transactions in the books of account?

Ans. The two accounting systems are:

(*i*) Double Entry System; and

(*ii*) Accounts from Incomplete Records or Single Entry System.

Q. 12. Name the external user of accounting information from whom the firm purchases goods on credit. (*KVS 2012*)

Ans. Supplier of goods.

Q. 13. Is the basic objective of Book Keeping to maintain systematic records or to ascertain net results of operations of financial transactions? (*MSE Chandigarh 2012*)

Ans. The basic objective of Book Keeping is to maintain systematic records of financial transactions.

Q. 14. Name the external users directly concerned with accounting information. (*MSE Chandigarh 2015*)

Ans. (*i*) Creditors, (*ii*) Bankers or Financial Institutions, and

(*iii*) Government and its Authorities.

Short Answer Type Questions

1. Explain the meaning of Accounting. (*Delhi 2011*)
2. What is the process of Accounting?
3. Define Book Keeping. What is the function of Book Keeping?
4. What is the difference between Book Keeping and Accounting? (*KVS 2003, 2006*)
5. Discuss briefly the types of Accounting Information.
6. Why the following parties are interested in Accounting Information:
   (*a*) Investors; (*b*) Government? (*MSE Chandigarh 2011*)

7. State what is the end-product of Financial Accounting. (*MSE Chandigarh 2008*)
   [**Hint:** Financial Statements, *i.e.*, (*i*) Income Statement, (*ii*) Balance Sheet.]
8. What are the attributes (features) of Accounting? (*MSE Chandigarh 2006*)
9. What do you mean by Accounting? What are its main objectives? (*KVS 2007*)
10. What are the advantages of Accounting? (*MSE Chandigarh 2003; Delhi 2004*)
11. Explain the primary objectives of Accounting. (*MSE Chandigarh 2009*)
12. Explain **any four** objectives of Accounting. (*KVS 2012*)
13. Define Accounting. Explain **any two** limitations of Accounting. (*MSE Chandigarh 2007; KVS 2008*)
14. What is Accounting? Explain **four** of its functions. (*Delhi 2001, 2002*)
15. What do you mean by Accounting? Explain in brief **any four** advantages of Accounting. (*Delhi 2010*)
16. What do you mean by Financial Accounting? Explain the **four** main limitations of Financial Accounting. (*Delhi 2004*)
17. Accounting provides information about the profitability and financial soundness of a concern. In addition, it provides various other valuable information also. However, accounting has certain limitations. Explain **any three** of such limitations. (*KVS 2015; KVS 2016*)
18. What do you mean by Financial Accounting? Explain its **one** main function. (*Delhi 2008*)
19. Write a short note on Double Entry System of Accounting.

Scan QR Code for Key Terms and Chapter Summary

CHAPTER 2

Basic Accounting Terms

LEARNING OBJECTIVES

This Chapter would enable you to understand:

Accounting Terms Prescribed in Syllabus:

- ❑ Business Transaction
- ❑ Account
- ❑ Capital
- ❑ Drawings
- ❑ Liabilities (Non-current and Current Liabilities)
- ❑ Assets [Non-current Assets, Current Assets and Fictitious Assets] (Fixed Assets—Tangible Assets and Intangible Assets)
- ❑ Receipts (Capital and Revenue)
- ❑ Expenditure (Capital, Revenue and Deferred Revenue)
- ❑ Expense (Prepaid and Outstanding)
- ❑ Income
- ❑ Profit
- ❑ Gains
- ❑ Losses
- ❑ Purchases
- ❑ Purchases Return
- ❑ Sales
- ❑ Sales Return
- ❑ Revenue from Operations
- ❑ Goods
- ❑ Stock/Inventory
- ❑ Trade Receivables (Debtors and Bills Receivable)
- ❑ Trade Payables (Creditors and Bills Payable)
- ❑ Cost
- ❑ Vouchers
- ❑ Discount—Trade and Cash

Other Important Accounting Terms:

- ❑ Bad Debts
- ❑ Balance Sheet
- ❑ Book Value
- ❑ Books of Account
- ❑ Cost of Goods Sold
- ❑ Credit
- ❑ Debit
- ❑ Depreciation
- ❑ Entity
- ❑ Entry
- ❑ Insolvent
- ❑ Proprietor
- ❑ Rebate
- ❑ Solvent
- ❑ Financial Statements or Final Accounts

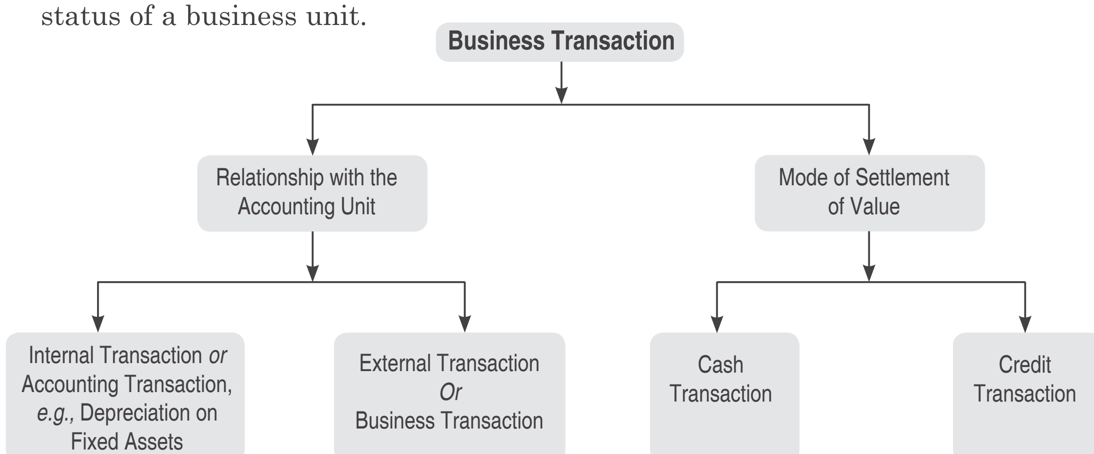
In business, various accounting terms are used. It is necessary to understand these terms as they are part of the standard accounting terminology.

1. Business Transaction: The term 'Business Transaction' means a financial transaction or economic event entered into by two parties that initiates the accounting process of recording it in the books of account of an enterprise. It is a financial event expressed in terms of money which brings a change in the financial position of an enterprise. Stating differently, it is an agreement between two parties involving transfer or exchange of goods or services. Examples of business transactions are sales of goods, purchases of goods, receipt from debtors, payment to creditors, purchase or sale of fixed assets, payment of interest, payment of dividend, etc.

Characteristics of a Business Transaction

1. It is concerned with money or money's worth of goods or services.
2. It arises out of the transfer or exchange of goods or services.
3. It brings about a change in the financial position (*i.e.*, in Assets and Liabilities).
4. It has an effect on the accounting equation of any business firm.
5. It has dual aspects or two sides—'Receiving' (Debit) and 'Giving' (Credit) of the benefit.

   In other words, every transaction has two sides—one is 'Receiving' the benefit and the other is 'Giving' the benefit.
6. After each transaction, the total assets of a business must be equal to its total liabilities and capital. Therefore, *the equality of the Balance Sheet* cannot be disturbed by any transaction.
7. The nature of each transaction is carefully analysed since it affects the financial status of a business unit.



A transaction may be a cash transaction or a credit transaction. When the amount is transacted (paid or received) immediately on entering into a transaction it is a *cash transaction* and when it is promised to pay later, it is a *credit transaction*. Transactions may be external (between a business entity and a second party, for example, goods sold on credit to *Z*) or internal (does not involve second party, *e.g.*, depreciation charged on machinery).

2. Account: It is a record of transactions (cash and credit) under a particular head of account (say Salaries, Telephone Expenses, Electricity Expenses, etc.) or a particular head (say asset, liability, etc.). It not only shows the amounts of transactions but also shows their effect and direction.

3. Capital: Capital is the amount invested in an enterprise by the proprietor (in case of proprietorship) or by partners (in partnership business). It may be in the form of money or assets having a monetary value. It is a liability of the business towards the proprietor or partners which increases with further investments made in the business and the amount of profit earned. On the other hand, it decreases when it is withdrawn (drawings) or loss is incurred by the business.

In the case of Companies, contributors of capital are many and they are known as **shareholders**.

It is a liability because under "Business Entity Concept", business is a separate and distinct entity from its owners. Transactions are recorded in the books of account from the point of view of business. 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

4. Drawings: It is the amount withdrawn or goods taken by the proprietor or partner for personal use. Goods so taken by the proprietor or partner are valued at purchase cost. Drawings reduces the investment (or capital) of the owners. Drawings by the proprietor or partner is debited to Drawings Account. At the time of preparing Balance Sheet, it is deducted from the capital of the proprietor or partner, as the case is.

5. Liabilities: Liabilities mean amount owed (payable) by the business. Liability towards the owners (proprietor or partners) of the business is termed as **internal liability**. On the other hand, liability towards the outsiders, *i.e.*, other than the owners (proprietor or partners) is termed as **external liability**.

External liability arises because of credit transactions or loans taken. Examples of external liability are creditors, bank overdraft, long-term borrowings, and other liabilities.

Liability is further classified into:

(*i*) *Non-current Liability:* Non-current Liability is that liability which is payable after a period of more than a year from the end of the accounting period. Examples of Non-current Liability are long-term loans, debentures, etc.

(*ii*) *Current Liability:* Current Liability is that liability which is payable within 12 months from the end of the accounting period. Examples of Current Liability are creditors, bills payable, short-term loans, etc.

Classification of Liabilities in case of Companies as per Schedule III of the Companies Act, 2013

Liability under Schedule III of the Companies Act, 2013 is classified into:

(*i*) Current Liabilities, and (*ii*) Non-current Liabilities

(*i*) *Current Liabilities:* A liability is a current liability if it satisfies any one of the following criterias:

(*a*) it is expected to be settled in the company's normal *operating cycle*; or

(*b*) it is held primarily for the purpose of being traded; or

(*c*) it is due to be settled within 12 months after the reporting date; or

(*d*) the company does not have an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

(*ii*) *Non-current Liabilities:* Non-current liabilities are those liabilities which are not current liabilities.

Operating Cycle means the time between the acquisition of an asset for processing and its conversion into Cash and Cash Equivalents. If the operating cycle cannot be identified, it is taken to be a period of 12 months.

Company Accounts is part of syllabus for Class XII.

6. Assets: Assets are the properties (tangible assets and intangible assets) owned by an entity or enterprise. They are the economic resources of the business. In other words, anything which will enable the firm to get economic benefit in the future, is an asset. Examples of assets are land, building, machinery, furniture, stock, debtors, cash and bank balances, trademarks, copyrights, goodwill, etc.

"*Assets are future economic benefits, the rights, which are owned or controlled by an organisation or individual.*" **—Finney and Miller**

"*Assets are property or legal right owned by an individual or a company to which money value can be attached.*" **—R. Brockington**

"*Assets are valuable resources owned by a business which are acquired at a measurable money cost.*" **—Prof. R.N. Anthony**

What emerges from the above definitions is that an asset should have the following characteristics:

1. It should be owned (*i.e.*, property) by the business.
2. It may be in tangible (physical) form or intangible form.
3. It should have some value attached to it.
4. It should be capable of being measured in money terms.

Assets can be classified into (*i*) Non-current Assets, (*ii*) Current Assets, and (*iii*) Fictitious Assets:

(*i*) *Non-current Assets:* Non-current Assets are those assets which are held by an entity or enterprise not with the purpose to resell but are held either as investment or to facilitate business operations. In other words, those assets are held by the business from a long-term point of view. Examples of non-current assets are Fixed assets, Non-current Investments, Long-term Loans and Advances and Other Non-current Assets.

Fixed Assets: Fixed assets are those non-current assets of an enterprise which are held not to resell but with the purpose to increase its earning capacity. Fixed assets are further classified into:

(*a*) *Tangible Assets:* Tangible Assets are those assets which have physical existence, *i.e.*, they can be seen and touched. Examples of tangible assets are land, building, machinery, computer, furniture, etc.

(*b*) *Intangible Assets:* Intangible Assets are those assets which do not have physical existence, *i.e.*, they cannot be seen and touched. Examples of intangible assets are patents, goodwill, trademarks, Computer Software, etc.

(*ii*) *Current Assets:* Current Assets are those assets which are held by an entity or enterprise with the purpose of converting them into cash within a short period, *i.e.*, one year. For example, goods are purchased with a purpose to resell and earn profit, debtors exist to convert them into cash, *i.e.*, receive the amount from them, bills receivable exist again for receiving cash against it, etc.

Prepaid expenses are also classified as Current Assets although they cannot be converted into cash. They are so classified because a part of the benefit from such expenses is available in the next accounting year.

(*iii*) *Fictitious Assets:* Fictitious Assets are those assets which are neither tangible assets nor intangible assets. They are losses not written off in the year in which they are incurred but in more than one accounting period.

In the case of firms, an example of fictitious asset is Deferred Revenue Expenditure such as Advertisement Expenditure. Discount or Loss on Issue of Debentures is an example of fictitious asset in the case of companies.

Classification of Assets in the case of Companies as per Schedule III of the Companies Act, 2013

Assets, like liabilities, are classified by Schedule III of the Companies Act, 2013 into (*i*) Current Assets, and (*ii*) Non-current Assets. They are defined as follows:

(*i*) *Current Assets:* An asset is a current asset if it satisfies any one of the following criterias:

(*a*) it is expected to be realised in or is intended for sale or consumption in the company's normal operating cycle; or

(*b*) it is held primarily for the purpose of being traded; or

(*c*) it is expected to be realised within 12 months from the reporting date; or

(*d*) it is Cash and Cash Equivalent unless it is restricted from being exchanged or used to settle a liability for at least 12 months after the reporting date.

(*ii*) *Non-current Assets:* Non-current Assets are those assets which are not current assets.

Operating Cycle means the time between the acquisition of an asset for processing and its conversion into Cash and Cash Equivalents. If the operating cycle cannot be identified, it is taken to be a period of 12 months.

7. Receipts: Receipt is the amount received or receivable for selling assets, goods or services. Receipts are further categorised into revenue receipts and capital receipts.

Revenue Receipts: It is the amount received or receivable in the normal course of business say against sale of goods or rendering of services or investment of business resources say in fixed deposit. They are shown in the Profit and Loss Account, in the case of enterprises and in Income and Expenditure Account in the case of Not-For-Profit Organisations. Examples of revenue receipts are: amount received or receivable against sale of goods or rendering of services, interest on fixed deposits or investments, etc.

Capital Receipts: It is the amount received or receivable against transactions which are not revenue in nature. They are shown in the Balance Sheet of the entity. For example, amount received or receivable from sale of machinery, building, furniture, investment, loan taken, etc.

8. Expenditure: Expenditure is the amount spent or liability incurred for acquiring assets, goods or services. Expenditure may be categorised into:

(*i*) *Capital Expenditure:* It is an expenditure incurred to acquire assets or improving the existing assets which will increase the earning capacity of the business, *i.e.*, will give benefit of enduring nature to the business. It may be incurred to acquire tangible asset or intangible asset. They are shown in the Balance Sheet of the entity. Examples of capital expenditure are purchase of machinery to manufacture goods, purchase of furniture or computers to carry on business.

Capital Expenditure is shown on the assets side of the Balance Sheet.

(*ii*) *Revenue Expenditure:* Revenue Expenditure is the expenditure incurred, the benefit of which is consumed or exhausted within the accounting period. It has direct relationship with revenue or with the accounting period, *e.g.*, cost of goods sold, salaries, rent, electricity expenses, etc.

Revenue Expenditure is shown on the debit side of the Trading Account or Profit and Loss Account, in the case of proprietorship or partnership enterprises and in the Expenses part of the Statement of Profit and Loss, in the case of companies. It is shown on the debit side of the Income and Expenditure Account in the case of Not-for-Profit Organisations.

(*iii*) *Deferred Revenue Expenditure:* Deferred Revenue Expenditure is a revenue expenditure in nature but is written off (charged) in more than one accounting period because it is estimated that benefit of such expenditure will accrue in more than one financial year. For example, large advertising expenditure that will give benefit for more than one accounting period is a Deferred Revenue Expenditure.

Revenue: Revenue is gross inflow of cash, receivables or other consideration arising in the course of ordinary activities of the enterprise from the sale of goods, from rendering of services and from the use by others of enterprise resources yielding interest, dividends, etc. Thus, revenue is the amount received or receivable by the enterprise from its operating activities. Examples of revenue are receipts from sale of goods, rent, commission, etc.

Revenue differs from income. Amount received against sale of goods and/or services rendered is revenue and cost of sale of goods and/or services is an expense. The difference between revenue and expense is income.

Income = Revenue – Expense

9. Expense: Expense is the cost incurred for generating revenue. According to **R.N. Anthony**, "*Expense is a monetary measure of inputs or resources consumed.*" It is a value which has expired during the accounting period. It may be

(*i*) cash payment such as salaries, wages, rent, etc.

(*ii*) writing off a part of fixed assets (*i.e.*, depreciation).

(*iii*) an amount written off out of a current asset (say bad debts).
(*iv*) decline in the value of assets (say investments).
(*v*) cost of goods sold.

An expense is charged (debited) to Trading Account or Profit and Loss Account.

Prepaid Expense: It is an expense that has been paid in advance and the benefit of which will be available in the following year or years. For example, insurance premium of ₹ 50,000 has been paid for one year beginning 1st October, 2017. The financial year ends on 31st March, 2018. It means premium for six months, *i.e.*, 1st April, 2018 to 30th September, 2018 amounting to ₹ 25,000 is paid in advance. Thus, the amount of premium paid in advance (₹ 25,000) is Prepaid Expense. It will be accounted as an expense in the financial year ending 31st March, 2019. In the Balance Sheet as at 31st March, 2018, it will be shown as a Current Asset.

Outstanding Expense: It is an expense that has been incurred but has not been paid. For example, an audit has been conducted by a firm of chartered accountants against which audit fee of ₹ 60,000 is payable. It means a liability of ₹ 60,000 has been incurred, which is yet to be paid. It is termed as **Outstanding Expense**. It is debited to the Profit and Loss Account and also shown under the head Current Liabilities in the Balance Sheet.

10. Income: Income is the profit earned during an accounting period. In other words, the difference between revenue and expense is termed as **Income**. It is a broader term than the term 'profit' and includes profit from activities other than its Operating Activities. For example, goods costing ₹ 15,000 are sold for ₹ 21,000, the cost of goods sold, *i.e.*, ₹ 15,000 is expense, the sale of goods, *i.e.,* ₹ 21,000 is revenue and the difference, *i.e.*, ₹ 6,000 is income. It can, therefore, be expressed as:

Income = Revenue – Expense

11. Profit: Profit means income earned by the business from its Operating Activities, *i.e.*, the activities carried out by the enterprise to earn profit. For example, profit earned from sale of goods and/or rendering of services.

Profit is further divided into gross profit and net profit.

Gross Profit: Gross Profit is the difference between revenue from sales and/or services rendered and its direct cost.

Net Profit: Net Profit is the profit after deducting total expenses from total revenue of the enterprise. In case total expenses are more than the total revenue, it is Net Loss.

12. Gain: Gain is the increase in owner's equity resulting from something other than the day to day earning from irregular or non-recurring nature. Stating differently, it is a profit that arises from transactions which are not the Operating Activities of the business but are incidental to it such as gain on sale of land, machinery or investments.

13. Loss: Loss is excess of expenses of a period over its revenues. It decreases the owner's equity. It is a broad term and includes loss incurred in its operating (business) activities, money or money's worth lost against which the firm receives no benefit, *e.g.*, cash or goods lost in theft and loss arising from events of non-recurring nature, *e.g.*, loss on sale of fixed assets.

14. Purchases: The term 'Purchases' is used for an account to record purchases of goods or raw materials for resale or for producing products which are also to be sold. The term 'purchases' includes both cash and credit purchases of goods. Goods purchased for cash are termed as **Cash Purchases** and goods purchased on credit are termed as **Credit Purchases**.

15. Purchases Return: Goods purchased may be returned to the seller for any reason, say, they are defective. Goods so returned are known as **Purchases Return** or **Returns Outward**.

16. Sales: The term 'Sales' is associated with or used for sale of goods. These goods may be purchased for resale or manufactured by the enterprise. The term 'Sales' includes both cash and credit sales. When goods are sold for cash, they are termed as **Cash Sales** and when sold on credit, they are termed as **Credit Sales**.

17. Sales Return: Goods sold when returned by the purchaser are termed as **Sales Return** or **Returns Inward**.

18. Revenue from Operations: Revenue from Operations means revenue earned by an enterprise (firm or company) from its operating activities. The term is defined in Schedule III of the Companies Act, 2013, a format in which Balance Sheet and Statement of Profit and Loss (Profit and Loss Account) is prepared. Examples of Revenue from Operations are sale of goods (Net Sales, *i.e.*, Sales – Sales Return), sale of services, (for non-financial enterprises) and interest earned, dividend received (financial enterprises).

19. Goods: Goods are the physical items of trade that are purchased to be sold. The term applies to all the items making up the sales or purchases of a business. Stating differently, they are the Stock-in-Trade of an enterprise, purchased or manufactured with the purpose of selling. For an enterprise dealing in home appliances such as TV, Fridge, AC, etc., are goods and for a Stationer, Stationery is goods.

20. Stock/Inventory: Stock (Inventory) is a tangible asset 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. Stock (Inventory) may be: (*i*) Opening Stock (Inventory) or (*ii*) Closing Stock (Inventory).

(*i*) *Opening Stock* (Inventory) is the stock-in-hand in the beginning of the accounting year. In other words, it is stock-in-hand at the end of the previous accounting year.

(*ii*) *Closing Stock* (Inventory) is the stock-in-hand at the end of the current accounting period.

Stock *or* Inventory may be of the following kinds:

(*i*) *Stock or Inventory of Goods:* Stock, Goods or Inventory in the case of a trading concern comprises stock (Inventory) of goods remaining unsold. In the case of manufacturing concern, it comprises processed goods manufactured for the purpose of sale. It is valued at cost or net realisable value, whichever is lower.

(*ii*) *Stock or Inventory of Raw Material:* It comprises the stock of raw material used for manufacturing of goods lying unused. For example, stock of cloth to be used for stitching shirts. It is valued at cost or net realisable value, whichever is lower.

(*iii*) *Work-in-Progress:* It is a stock that is in the process of being finished, *i.e.*, they are partly finished goods. It is valued at an aggregate of cost of raw material used, cost of labour, other production cost, *i.e.*, power, fuel, etc.

Stock or Inventory is shown in the Balance Sheet as a *Current Asset*. It is valued on the basis of "*cost or net realisable value (market price), whichever is lower*" principle.

21. Trade Receivables: It is the amount receivable for sale of goods and/or services rendered in the ordinary course of business. Stating differently, it is the amount due from the customers of the enterprise.

Trade Receivables is a sum total of debtors and bills receivable.

Debtor: Debtor is a person or an entity who owes amount to the enterprise against credit sales of goods and/or services rendered. Goods when sold to a person on credit that person is called a **Debtor** because he owes that much amount to the enterprise.

Bill Receivable: Bill Receivable means a Bill of Exchange accepted by a debtor, the amount of which will be received on the specified date.

Trade Receivables as defined in Schedule III of the Companies Act, 2013

Trade Receivables are the amounts receivable by the enterprise against goods sold and services rendered in the normal course of business.

22. Trade Payables: It is the amount payable for purchase of goods and/or services taken in the ordinary course of business. Stating differently, it is the amount due to the seller of goods by the enterprise.

Trade Payables is the sum total of creditors and bills payable.

Creditor: Creditor is a person or an enterprise to whom an enterprise owes amount against credit purchases of goods and/or services taken. For example, Mohan is a creditor of a firm when goods are purchased from him on credit.

Bill Payable: Bill Payable means a Bill of Exchange accepted by the person or enterprise, the amount of which will be payable on the specified date.

Trade Payables as defined in Schedule III of the Companies Act, 2013

Trade Payables are the amounts payable by the enterprise against goods purchased and services taken in the normal course of business.

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

24. Voucher: Voucher is an evidence of a business transaction. Examples of voucher are Cash Memo, Invoice or Bill, Receipt, Debit/Credit Notes, etc.

25. Discount: It is the reduction in the price of goods or from the amount to be paid to a customer by the enterprise. Discount allowed may be Trade Discount or Cash Discount.

Trade Discount: Trade Discount is the reduction in prices by the seller to the purchaser of goods when they buy goods of certain quantity or value. Sales are recorded at net value, *i.e.*, Sales – Trade Discount. Similarly, purchases are recorded by the purchaser at net value, *i.e.*, Purchases – Trade Discount.

Cash Discount: Cash Discount is the discount allowed for timely payment of due amount. It is an expense for the party allowing the discount and income for the party receiving cash discount. It is recorded in the books of account of both the parties.

The accounting terms discussed above have been prescribed in the syllabus. We are discussing below some other important accounting terms as well.

26. Bad Debts: Bad Debt is the amount owed to the business that is written off because it has become irrecoverable. It is a loss for the business and is, thus, debited to Profit and Loss Account.

27. Balance Sheet: It is a statement of the financial position of an individual or enterprise at a given date, which exhibits its assets, liabilities, capital, reserves and other account balances at their respective book values.

28. Book Value: This is the amount at which an item appears in the books of account or financial statements.

29. Books of Account: The records or books in which financial transactions of an entity are recorded and maintained. They include Cash Book, Bank Book, Journal and Ledger.

30. Cost of Goods Sold: Cost of Goods Sold is the direct cost attributable to the production of goods sold and/or services rendered.

31. 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. It has been derived from an Italian word 'Credito'.

32. Debit: An account has two parts, *i.e.*, debit and credit. The left side is the debit side while 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. It has been derived from an Italian word 'Debito'.

33. Depreciation: Depreciation is a fall in the value of an asset because of usage or with efflux of time or obsolescence or accident. It is an allocation of cost of fixed asset in each accounting year during its estimated useful life.

34. Entity: An *Entity* means an economic unit which performs economic activities (*e.g.*, Reliance Industries, Bajaj Auto, Maruti, TISCO). A business entity means an enterprise established in accordance with law to engage in business activities. These include proprietorship firms, partnership firms, corporations, companies, etc. An accounting system is always devised for a specific business entity (also called **Accounting Entity**).

35. Entry: A transaction and event when recorded in the books of account is known as an **Entry**.

36. Insolvent: Insolvent is a person or enterprise which is not in a position to pay its debts.

37. Proprietor: The person who makes the investment and bears all the risks associated with the business is called **proprietor**.

38. Rebate: It is reduction in price allowed by the seller of goods after the goods have been sold. Stating differently, rebate is offered and allowed on sales completed in the past. It is allowed for the reasons other than for which trade discount and cash discount are allowed. For example, discount allowed because of poor quality of goods.

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

40. Financial Statements or Final Accounts: They are Trading Account, Profit and Loss Account (Statement of Profit and Loss, in the case of Companies) and Balance Sheet prepared at the end of accounting process.

Illustration.

Mr. Prem commenced business of trading in electronic goods with an initial capital of ₹ 15,00,000. Out of the said ₹ 15,00,000, he paid ₹ 10,00,000 towards purchase of electronic goods. He further spent ₹ 2,00,000 on furnishing the shop and ₹ 35,000 for purchase of computer and printer. ₹ 10,000 is yet to be paid to supplier of computer.

He sold goods costing ₹ 5,00,000 for ₹ 7,00,000 in cash and goods costing ₹ 2,50,000 for ₹ 3,10,000 on credit. Goods sold on credit for ₹ 25,000 were returned being defective. These goods (costing ₹ 20,000) were returned to the supplier. Looking into the response, he decided to trade in home appliances also and further invested ₹ 5,00,000.

He purchased electronic goods and home appliances for ₹ 8,00,000 out of which purchases of ₹ 2,00,000 were on credit.

Due to an earthquake, 2 LCD Televisions costing ₹ 50,000 were completely destroyed. Mr. Prem received an insurance claim of ₹ 30,000.

A customer purchased goods costing ₹ 2,25,000 for ₹ 3,00,000 and was allowed discount of ₹ 15,000. He was further allowed discount of ₹ 5,000 for payment within agreed time.

He paid salary to Shyam of ₹ 55,000; ₹ 5,000 were yet to be paid. He insured the goods and paid insurance premium of ₹ 10,000. Out of this, ₹ 5,000 are for the next year. Mr. Prem withdrew ₹ 30,000 during the year for his personal use.

You are required to answer the following questions on the basis of the above:

(*i*) What is the amount of capital invested in the business by Mr. Prem?
(*ii*) What is the amount invested by Mr. Prem in fixed assets?
(*iii*) What is the amount of total purchases?
(*iv*) What is the amount of long-term liabilities?
(*v*) What is the amount of current liabilities?
(*vi*) What is the amount of prepaid expenses?
(*vii*) What is the amount of outstanding expenses?

(*viii*) What is the income earned by Mr. Prem?

(*ix*) How much profit is earned by Mr. Prem?

(*x*) What is the amount due from debtors?

(*xi*) What is the amount due to creditors?

(*xii*) What is the value of Closing Stock?

(*xiii*) What is the value of net purchases?

(*xiv*) What is the amount of Trade Discount allowed?

(*xv*) Has Mr. Prem allowed Cash Discount? If yes, what is the amount?

(*xvi*) What is the amount of Drawings?

(*xvii*) What is the amount of Sales Return?

(*xviii*) What is the amount of Purchases Return?

Solution:

(*i*) Capital invested by Mr. Prem in the business is ₹ 20,00,000 (*i.e.*, ₹ 15,00,000 + ₹ 5,00,000).

(*ii*) Mr. Prem has invested ₹ 2,35,000 (*i.e.,* ₹ 2,00,000 + ₹ 35,000) in the fixed assets.

(*iii*) Purchases made by Mr. Prem are ₹ 18,00,000 (*i.e.*, ₹ 10,00,000 + ₹ 8,00,000) during the year.

(*iv*) Long-term liabilities of Mr. Prem are nil.

(*v*) Current liabilities of Mr. Prem are ₹ 1,95,000 [₹ 10,000 (Computer and Printer) + ₹ 2,00,000 (Purchases) + ₹ 5,000 (Salaries) – ₹ 20,000 (Purchases Return)].

(*vi*) Amount of prepaid expenses is ₹ 5,000 being insurance premium.

(*vii*) Outstanding expenses are ₹ 5,000 being salary payable.

(*viii*) Income earned by Mr. Prem is ₹ 1,75,000 [₹ 12,70,000 (Sales) – ₹ 10,95,000 (Expenses)].

(*ix*) Profit earned by Mr. Prem is ₹ 1,75,000 as he has no income from non-operating activities.

(*x*) Amount due from debtors is ₹ 2,85,000.

(*xi*) Amount due to creditors is ₹ 1,80,000.

(*xii*) The value of Closing Stock is ₹ 7,75,000.
[₹ 10,00,000 + ₹ 20,000 + ₹ 8,00,000 – ₹ 5,00,000 – ₹ 2,50,000 – ₹ 20,000 – ₹ 50,000 – ₹ 2,25,000 = ₹ 7,75,000].

(*xiii*) The amount of net purchases is ₹ 17,80,000.

(*xiv*) The amount of Trade Discount allowed is ₹ 15,000.

(*xv*) Yes, Mr. Prem has allowed cash discount and the amount is ₹ 5,000.

(*xvi*) The amount of Drawings is ₹ 30,000.

(*xvii*) The amount of Sales Return is ₹ 25,000.

(*xviii*) The amount of Purchases Return is ₹ 20,000.

QUESTIONS

Multiple Choice Questions (MCQs)

1. *Select the correct alternative:*

(*i*) Capital is
(*a*) internal liability. (*b*) external liability.
(*c*) internal as well as external liability. (*d*) None of these.

(*ii*) Goods taken by the proprietor for personal use is
(*a*) Sale. (*b*) Drawings.
(*c*) Purchase. (*d*) None of these.

(*iii*) Amount received or receivable against sale of goods is
(*a*) revenue receipt.
(*b*) capital receipt.
(*c*) sometimes revenue receipt and sometimes capital receipt.
(*d*) None of these.

(*iv*) Amount paid or payable against purchase of goods is
(*a*) revenue expenditure. (*b*) capital expenditure.
(*c*) Both (*a*) and (*b*). (*d*) None of these.

(*v*) Goodwill is a/an
(*a*) Tangible Asset. (*b*) Intangible Asset.
(*c*) Current Asset. (*d*) Fictitious Asset.

(*vi*) Expenditure of revenue nature that gives benefit for more than one accounting period is categorised as
(*a*) Capital Expenditure. (*b*) Revenue Expenditure.
(*c*) Deferred Revenue Expenditure. (*d*) None of these.

(*vii*) A person who owes money to a firm against goods sold is called a
(*a*) creditor. (*b*) debtor.
(*c*) Both (*a*) and (*b*) (*d*) None of these.

(*viii*) A person to whom money is owed by a firm for purchase of goods is called a
(*a*) creditor. (*b*) debtor.
(*c*) Both (*a*) and (*b*) (*d*) None of these.

(*ix*) Purchase refers to the purchase of
(*a*) goods for resale. (*b*) stationery for office use.
(*c*) assets for the factory. (*d*) None of the above.

(*x*) A liability arises because of
(*a*) cash transactions. (*b*) credit transactions.
(*c*) cash as well as credit transactions. (*d*) None of these.

(*xi*) The amount invested by the proprietor in a business is called
(*a*) capital. (*b*) cash.
(*c*) revenues. (*d*) loan.

(*xii*) Stock is valued at

(*a*) Cost or Net Realisable Value (Market Value), whichever is lower.

(*b*) Cost or Net Realisable Value (Market Value), whichever is higher.

(*c*) Cost.

(*d*) Net Realisable Value (Market Value).

(*xiii*) Bank overdraft is

(*a*) short-term liability. (*b*) long-term liability.

(*c*) contingent liability. (*d*) None of these.

(*xiv*) Which of the following is not a business transaction?

(*a*) Bought furniture of ₹ 25,000 for business.

(*b*) Paid for salaries of employees, ₹ 20,000.

(*c*) Cash withdrawn from personal bank account, ₹ 10,000 for domestic use.

(*d*) All of the above.

(*xv*) Which of the following is not a fixed asset?

(*a*) Building (*b*) Plant and Machinery

(*c*) Balance with bank (*d*) Goodwill

(*xvi*) Which of the following is not a long-term liability?

(*a*) Creditors (*b*) Term-loan

(*c*) Debentures (*d*) Capital

(*xvii*) Which of the following are goods?

(*a*) Machines manufactured for sale.

(*b*) Furniture purchased for sale.

(*c*) Books and stationery purchased by a book seller.

(*d*) All of the above.

(*xviii*) Which of the following is an asset?

(*a*) Machinery (*b*) Purchases

(*c*) Sales Return (*d*) Interest Received

(*xix*) Which of the following is a liability?

(*a*) Furniture (*b*) Rent Payable

(*c*) Interest Received (*d*) Stock

(*xx*) Which of the following is revenue?

(*a*) Purchases (*b*) Purchases Return

(*c*) Sales (*d*) Salary Payable

(*xxi*) Which of the following is not an expense?

(*a*) Furniture (*b*) Salary

(*c*) Rent (*d*) Electricity Expenses

(*xxii*) Which of the following is a business transaction?
(*a*) Goods purchased on credit.
(*b*) An employee being dismissed.
(*c*) Proprietor purchasing a car for own use.
(*d*) Sale of personal asset by the proprietor.

(*xxiii*) The nature of capital is
(*a*) an asset. (*b*) a liability.
(*c*) an income. (*d*) an expense.

(*xxiv*) Sale is recognised as revenue
(*a*) when the contract for sale is entered into.
(*b*) at the point of sale or performance of service.
(*c*) after the expiry of credit period allowed to debtors.
(*d*) after the money collected from the customers.

(*xxv*) The nature of accrued income is
(*a*) revenue. (*b*) liability.
(*c*) expenses. (*d*) asset.

(*xxvi*) Trade Discount allowed
(*a*) is shown separately in the books of account.
(*b*) is not shown separately in the books of account.
(*c*) can be shown either separately or deducted from purchase cost.
(*d*) None of the above.

(*xxvii*) Which of the following transaction is not of financial character?
(*a*) Purchase of asset on credit
(*b*) Purchase of asset for cash
(*c*) Withdrawing of money by proprietor from business
(*d*) Strike by employees. (*KVS 2015*)

(*xxviii*) Purchase refers to the buying of
(*a*) Stationery for office use. (*b*) Assets for the factory.
(*c*) Goods for resale. (*d*) Investment. (*KVS 2015*)

(*xxix*) Revenue from Operations refers to
(*a*) Revenue earned from Operating Activities.
(*b*) Revenue earned from activities that are not Operating Activities.
(*c*) Both (*a*) and (*b*).
(*d*) None of the above.

(*xxx*) Out of the following assets, which one is not an intangible asset?
(*a*) Machinery (*b*) Patents
(*c*) Goodwill (*d*) Trade Mark

[(*i*) (*a*); (*ii*) (*b*); (*iii*) (*a*); (*iv*) (*a*); (*v*) (*b*); (*vi*) (*c*); (*vii*) (*b*); (*viii*) (*a*); (*ix*) (*a*); (*x*) (*b*); (*xi*) (*a*); (*xii*) (*a*); (*xiii*) (*a*); (*xiv*) (*c*); (*xv*) (*c*); (*xvi*) (*a*); (*xvii*) (*d*); (*xviii*) (*a*); (*xix*) (*b*); (*xx*) (*c*); (*xxi*) (*a*); (*xxii*) (*a*); (*xxiii*) (*b*); (*xxiv*) (*b*); (*xxv*) (*d*); (*xxvi*) (*b*); (*xxvii*) (*d*); (*xxviii*) (*c*); (*xxix*) (*a*); (*xxx*) (*a*).]

2. *Determine, if the following are Assets, Liabilities, Capital, Revenue from Operations, Revenues, Expenses or none:*
(*a*) Machinery, (*b*) Purchases, (*c*) Stock, (*d*) Creditors, (*e*) Capital, (*f*) Salary paid to a clerk, (*g*) Sales, (*h*) Furniture, (*i*) Interest received and (*j*) Rent paid.
[(*a*) *Asset;* (*b*) *Expense;* (*c*) *Asset;* (*d*) *Liability;* (*e*) *Capital;* (*f*) *Expense;* (*g*) *Revenue from Operations;* (*h*) *Asset;* (*i*) *Revenue;* (*j*) *Expense.*]

Very Short Answer Type Questions

Q. 1. What is meant by Cash Transaction?
Ans. Cash transaction is a financial transaction or event that is settled immediately in cash.

Q. 2. What is meant by Credit Transaction?
Ans. Credit transaction is a financial transaction or event that is not settled immediately, *i.e.*, is agreed to be settled later.

Q. 3. Briefly explain Expenditure.
Ans. Expenditure is the amount spent or liability incurred for acquiring assets, goods or services.

Q. 4. What are Assets?
Ans. Asset is a property (land, machine, goods, premises, etc.) or legal rights (patents, copyrights, etc.) owned by an individual or business which can be measured in money terms.

Q. 5. What are Fixed Assets?
Ans. Fixed Assets are the assets which are acquired not with a purpose to resell but with a purpose to increase the earning capacity of the business.

Q. 6. What is meant by Tangible Assets? (*MSE Chandigarh 2015*)
Ans. Tangible Assets are the assets which have physical existence, *i.e.*, they can be seen and touched such as Land, Building, Plant and Machinery and Computers.

Q. 7. Briefly explain Intangible Assets.
Ans. Intangible Assets are the assets which do not have a physical existence, *i.e.*, they cannot be seen or touched such as Computer Software and Goodwill.

Q. 8. Briefly explain the term 'Goods'. (*MSE Chandigarh 2012*)
Ans. Goods are the physical items of trade.

Q. 9. Define the term 'Purchase'. (*KVS 2016*)
Ans. The term 'Purchase' is used for purchase of goods for resale or for producing the finished products which are also to be sold. The term 'purchase' includes both cash and credit purchases of goods. Goods purchased for cash are termed as **Cash Purchases** and goods purchased on credit are termed as **Credit Purchases**.

Q. 10. What are the main classes of Liabilities?
Ans. Non-current Liabilities and Current Liabilities.

Q. 11. Give **any two** examples of Current Assets. (*KVS 2007*)
Ans. Stock-in-Trade (Inventories) and Cash in Hand.

Q. 12. Name **three** Current Liabilities.
Ans. Creditors, Bills Payable and Outstanding Expenses.

Q. 13. Name **two** Long-term Liabilities.
Ans. Long-term loans and Debentures.

Q. 14. Explain Capital briefly.

Ans. Capital is the amount invested by the proprietor or the partner in the business.

Q. 15. Who is a Debtor?

Ans. Debtor is a person who owes amount to the business on account of credit sales of goods and/or services in the normal course of business.

Q. 16. Who is a Creditor?

Ans. Creditor is the person to whom an amount is owed on account of credit purchases of goods and/or services in the normal course of business.

Q. 17. What is meant by Revenue from Operations?

Ans. Revenue from Operations means revenue earned by the enterprise from its Operating Activities such as Net Sales (Sales – Sales Return), services rendered, sale of scrap, etc.

Q. 18. What is an Income?

Ans. Income is profit earned during the accounting period, *i.e.*, revenue *minus* expenses.

Q. 19. Define Drawings with example. (*Delhi 2012*)

Ans. Drawings is the amount of money or value of goods which the proprietor or partner withdraws for personal use. For example, withdrawal of cash by the proprietor for personal use.

Q. 20. Define Voucher. (*MSE Chandigarh 2012*)

Ans. Voucher is an evidence of a business transaction.

Q. 21. Define Merchandise. (*MSE Chandigarh 2012*)

Ans. Merchandise means goods for resale.

Q. 22. A firm earns a revenue of ₹ 21,000 and the expenses to earn this revenue are ₹ 15,000. Calculate its income. (*Delhi 2009*)

Ans. Income = Revenue – Expense = ₹ 21,000 – ₹ 15,000 = ₹ 6,000.

Q. 23. A firm has received a large order to supply goods. Will it be recorded in the books of account of the firm? Give reason. (*MSE Chandigarh 2015*)

Ans. *No*, it will not be recorded in the books of account because it is not a transaction.

Short Answer Type Questions

1. Distinguish between Loss and Expense.
2. What are Vouchers?
3. Distinguish between Opening Stock and Closing Stock.
4. Explain the meaning of **any three** of the following terms:
   (*i*) Assets; (*ii*) Capital; (*iii*) Goods; (*iv*) Drawings and (*v*) Debtors. (*Delhi 2007*)
5. Explain the following terms:
   (*i*) Revenue; (*ii*) Debtors; (*iii*) Fictitious Assets and (*iv*) Working Capital. (*MSE Chandigarh 2007*)

   [**Hint:** The difference between the Current Assets and Current Liabilities is known as **Working Capital**.]
6. Explain the meaning of **any three** of the following terms:
   (*i*) Liability; (*ii*) Stock; (*iii*) Business Transaction and (*iv*) Drawings. (*Delhi 2008*)

7. Explain and give example of each of the following accounting terms:
   (*i*) Expenses; (*ii*) Drawings and (*iii*) Gain. (*KVS 2010*)
8. Define the following basic accounting terms with example:
   (*i*) Revenue; (*ii*) Drawings and (*iii*) Profit. (*Delhi 2010*)
9. Explain the following terms with example:
   (*i*) Sales and (*ii*) Cost. (*Delhi 2011*)
10. Write a note on types of assets with one example of each. (*KVS 2015*)

PRACTICAL PROBLEM

1. Mr. Gopal started business for buying and selling of readymade garments with ₹ 8,00,000 as an initial investment. Out of this he paid ₹ 4,00,000 for the purchase of garments and ₹ 50,000 for furniture and ₹ 50,000 for computers and the remaining amount was deposited into the bank. He sold some of the ladies and kids garments for ₹ 3,00,000 for cash and some garments for ₹ 1,50,000 on credit to Mr. Rajesh.

   Subsequently, he bought men's garments of ₹ 2,00,000 from Mr. Satish. In the first week of the next month, a fire broke out in his office and stock of garments worth ₹ 1,00,000 was destroyed. Later on, some garments which cost ₹ 1,20,000 were sold for ₹ 1,30,000. Expenses paid during the same period were ₹ 15,000. Mr. Gopal withdrew ₹ 20,000 from business for his domestic use.

   From the above, answer the following:

   (*i*) What is the amount of capital with which Mr. Gopal started the business?
   (*ii*) What fixed assets did he buy?
   (*iii*) What is the value of the goods purchased?
   (*iv*) Who is the creditor and state the amount payable to him?
   (*v*) Who is the debtor and what is the amount receivable from him?
   (*vi*) What is the total amount of expenses?
   (*vii*) What is the amount of drawings of Mr. Gopal?

[(*i*) ₹ *8,00,000;* (*ii*) *Furniture* ₹ *50,000 and Computer* ₹ *50,000;*
(*iii*) ₹ *4,00,000* + ₹ *2,00,000* = ₹ *6,00,000;* (*iv*) *Mr. Satish*—₹ *2,00,000;*
(*v*) *Mr. Rajesh*—₹ *1,50,000;* (*vi*) ₹ *6,15,000;* (*vii*) ₹ *20,000.*]