

## 3

# ACCOUNTING TERMS

Every subject has certain important basic terms, and Accountancy is no exception. These terms facilitate the understanding of the subject. Hence, this lesson has been designed to acquaint you with the knowledge of some important basic accounting terms. The entire structure of Accounting rests upon these terms. The terms, that we frequently use, are Assets, Liabilities, Revenue and Expenses.



## OBJECTIVES

After studying this lesson, you will be able to :

- define various accounting terms such as Capital, Drawings, Assets, Liability, Revenue, Expenditure, Expense, Profit, Losses, Purchases, Sales, Stock, Debtors, Creditors, Receivables, Payables, Debit, Credit etc. and
- identify these terms through case study.

### 3.1 ACCOUNTING TERMINOLOGY

One should be well aware of the various terms used in accounting so as to feel comfortable with various aspects of accounting and make it clear and understandable.

**Capital :** This is the amount invested by the owners in the business. It is also called as owner's equity. Owner's equity is the owner's stake in the business. It shows how much is his investment in the assets of the business.

**Drawings :** It is the amount of cash or goods drawn by the proprietor from the business for his personal or domestic use.

**Assets :** Any thing that is owned by an individual or business and which can be valued in terms of money is called an asset. In other words, any thing which will enable the firm to get cash or a benefit in future is an asset. For example land, building, machinery, furniture, stock, debtors, bank balance and cash etc.

#### Classification of Assets

i) **Fixed Assets :** The assets which are acquired not for resale but with the

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purpose to increase the earning capacity of the business by employing them. For example - land, building, machinery, computer, furniture, vehicles, live stock etc.

- ii) **Current Assets** : Current Assets are those assets which are retained in the business with the purpose to convert them into cash within a short period of time say one year. For example - cash in hand, bills receivables, debtors, stock (goods) etc.
- iii) **Tangible Assets** : The assets which can be seen and touched or have physical existence. For example - building, machinery, furniture, computer etc.
- iv) **Intangible Assets** : The assets which cannot be seen and touched or which do not have physical existence. For example - goodwill, trade mark, patents etc.
- v) **Wasting Assets** : Wasting assets are those assets which are natural resources extracted and consumed as a raw material or otherwise. For example - mines, quarries, oil wells etc.

**Liability** : The assets of a business concern are financed by the funds supplied by the proprietors and outsiders. Money is invested by the proprietor to start his business. Money is also borrowed from others and invested in business. With this money assets are purchased. So the proprietor and outsiders have a claim against the assets of the business. This claim of the proprietor and outsiders is termed as 'Liabilities'. In other words, any amount which the firm owes to the proprietors and outsiders is liability for the business unit. Hence, liabilities are the obligations or debts payable by the business unit in future.

Liabilities have been classified as:

- i) External Liabilities
- ii) Internal Liabilities

### i) External Liabilities

External liabilities are those liabilities which the business owes to the outsiders for goods purchased on credit, for expenses or for loans taken. For example :

**Creditors for goods** : Sundry creditors, bills payable

**Creditors for expenses** : Expenses yet to be paid like outstanding salaries, wages outstanding, rent due but not yet paid.

**Creditors for loans** : Bank loan, Bank overdraft, partners loan, loans taken from other outsiders.

### ii) Internal liabilities

Internal liabilities are those liabilities which the business owe to the owners

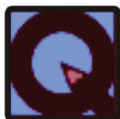
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or proprietors. It is the proprietor's claim against the assets of the business. The Business Entity Assumption states that business is separate from its owners. Any amount contributed by the owner towards the business concern is a liability for the business concern. This liability is also termed as Capital. Hence, the owner's claim against the assets of the business unit is called as capital. In case of one man business or sole proprietorship the capital is contributed by the proprietor himself. In case of partnership business firm, capital is contributed by the partners, and in case of companies, capital is contributed by the shareholders. Owners of the business are those who contribute capital. They get profit of the business, for the risk taken by them. So, the owners have a claim against the firm which is a liability for the firm.

Owner's claim can be expressed as:

- a) Capital
- b) Interest on Capital (unpaid)
- c) Profits of the business (undistributed)
- d) Reserves.

Hence, capital is also a liability for the business unit.



### INTEXT QUESTIONS 3.1

#### I. Fill in the blanks with suitable words :

- i. Outsider's and owner's claim against the assets of the firm is called \_\_\_\_\_.
- ii. Liabilities are classified into two categories \_\_\_\_\_ and \_\_\_\_\_.
- iii. Owner's claim is \_\_\_\_\_ liability.
- iv. Outsider's claim is \_\_\_\_\_ liability.
- v. Owner's claim against the assets of the business is also called as \_\_\_\_\_.

#### II. Classify the following items into external and internal liabilities :

- i. Bank loan
- ii. Interest on capital (unpaid)
- iii. Capital
- iv. Sundry Creditors
- v. Outstanding rent
- vi. Undistributed Profits
- vii. Bills Payable
- viii. Bank Overdraft
- ix. Salaries due but not paid
- x. Reserves

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**Revenue :** Revenue refers to the inflow of money or other assets that results from the sale of goods or services or from the use of money. It is the amount realized or receivable from the sale of goods. Amount received from sale of assets or borrowing loan is not revenue. In broader sense, revenue is also used to mean receipt of rent, commission, discount, etc. Such inflows should be regular in nature and should be concerned with the day-to-day affairs of the business. It should be calculated in the period in which it is earned or realized. For example, sale of goods, rent received, interest on investment received, etc.

Revenue should not be confused with income. Income is the difference between revenue and expense.

**Expenses :** Let us consider an example before we understand meaning of expense. Rakesh has a textile mill. He purchases raw cotton and converts it into cloth. For this purpose, he has engaged employees to whom he pays daily wages. He also has a showroom where he sells the cloth that he produces. He has three salesman to whom he pays salaries. In order to sell his product he has given advertisements in the newspapers and television. He has done all this to earn profits. For Rakesh, cost of raw cotton, wages, salaries and advertisement cost are all expenses which he has incurred in order to earn revenue. All costs incurred in earning revenue is called as expense. It refers to the cost which is incurred in acquiring an asset or service, e.g. transportation cost incurred in transferring the raw cotton from the village to the factory. It is the amount spent in order to produce and sell the goods and services to earn the revenue, for example, cost of raw material, carriage, wages, insurance premium, rent paid for office, etc.

**Expenditure:** Expense may be different from expenditure. Expenditure is generally the amount spent for the purchase of assets. It increases the profit earning capacity of the business, for example, furniture purchased, machines purchased, etc. Expense, on the other hand, is an amount to earn revenue. Some examples of expenses are the payments made for rent, wages, salaries, etc.

It can also be said that expenditure is considered as capital expenditure unless it is qualified with words like revenue expenditure on rent, salaries, etc. while expense is always considered as a 'revenue expense' because it is always incurred to earn revenue.

**Profit :** It is the excess of business revenue over the business expenses for a period. It is an addition to the owner's equity.

**Losses :** It is the decrease in the value of net assets. It is the excess of business expenses incurred over the business revenue earned during the year. It decreases the owners equity.

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**Purchases :** Purchases always refer to purchases of merchandise. Purchases means the purchases of such goods and services in which a firm deals. Purchases of cars for an automobile dealer are purchases. For any other firm it is not a purchase.

**Sales :** It means exchange of such goods and services for money in which the firm deals in. One of the most important objective of a business is to make profit. This objective is achieved by selling goods and services at a price higher than their cost.

**Stock :** It means, in case of a trader, all the goods or merchandise that he has for sale in the ordinary course of business. In case of a manufacturer, stock may consist of:

- (a) Raw-material to be used for manufacturing goods;
- (b) Semi-finished products or goods (i.e., raw-material in the process of manufacturing and which has not yet been finished and which is not yet fit for sale or subsequent use);
- (c) Finished products or goods.

The goods meant for sale in case of a trader and raw material/semi-finished goods/finished products for sale in case of a manufacturer are stock-in-trade or inventory.

**Receivables :** In addition to debtors there may be some other persons also who owe money to the business. They are called receivables. This includes Bills Receivables also.

**Payables :** In addition to creditors there may be some other persons to whom the business owes money. This includes Bills Payables also. These are called payables.

**Debtor and Creditor :** The two other terms which are quite often used in the recording of transactions are 'debtor' and 'creditor'. A thorough understanding of these terms is very essential.

A debtor is a person *who owes* money. A creditor is a person *to whom* money is *owing*. A person becomes a debtor when he receives some benefit. It may be in the form of money, goods, or services. A person becomes a creditor when he yields (gives) some benefit.

Example – Ram sells goods to Dass on credit.

From the point of view of Ram, Dass is a debtor, as Dass is receiving a benefit in the form of goods.

From the point of view of Dass, Ram is a creditor, as Ram is yielding a benefit in the form of goods.

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**Debit and Credit :** You should observe that every business transaction involves a debit and a credit. The debit amounts are equal to credit amounts. This practice of having equal debits and credits is called Double Entry Book-keeping. Under this system every transaction has two aspects - as debit aspect and credit aspect and at the time of recording a transaction, both these aspects are recorded.

**3.2 CASE STUDY**

Jay started a business with cash ₹ 2,00,000 on 1.4.2012. He opened a bank account by depositing ₹ 50,000 on the same date. On 2.4.2012 he obtained a loan of ₹ 1,00,000 from SBI. On 3.4.2012 he purchased goods of ₹ 70,000 from Ravi on credit. On the same date he gave a bills payable to Ravi which will become due after two months. On 12.4.2012 the machinery purchased from M/s Kailash Stores on credit for ₹ 50,000. On 13.4.2012 he sold goods for cash ₹ 12,000 and on credit to Ram ₹ 9,000. On the basis of your knowledge about basic accounting terms identify the accounting terms involved in the above transaction of Jay.

**Solution**

On the basis of above case study the following accounting terms can be identified:

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Capital	2,00,000
Bank Balance	1,50,000
Loan (Liability)	1,00,000
Ravi Creditor (Liability)	70,000
Bills Payable (In lieu of Ravi Creditor liability)	70,000
Machinery (Assets)	50,000
Kailash Stores (Liability)	50,000
Sales (Revenue)	21,000
Cash (Assets)	12,000
Ram (Debtor)	9,000

**INTEXT QUESTIONS 3.2****I. Fill in the blanks with suitable words :**

- i. Inflow of money from sale of goods is called as \_\_\_\_\_ .
- ii. Outflow of money to earn profit is called as \_\_\_\_\_ .
- iii. Expense is incurred in order to earn \_\_\_\_\_ .
- iv. Money spent in order to purchase assets is called \_\_\_\_\_ .

**II. From the following identify revenues, expenses and expenditure.**

- i. Rent Received

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- ii. Salaries Paid
- iii. Cost of Raw Material
- iv. Furniture Purchased
- v. Commission Received
- vi. Insurance Premium Paid
- vii. Machines Purchased
- viii. Advertising

### III. Classify the given items into assets, liabilities, capital, revenue and expense.

- i. Stock-in-hand
- ii. Rent Paid
- iii. Advertising
- iv. Creditors
- v. Outstanding Expense (rent)
- vi. Interest Received
- vii. Capital Introduced
- viii. Furniture and Fittings
- ix. Insurance Premium Prepaid
- x. Commission Received in Advance
- xi. Debtors
- xii. Dividend Received
- xiii. Cash at bank
- xiv. Salaries Paid
- xv. Discount Received
- xvi. Land and Building

### IV. Multiple Choice Questions

- i. Capital is the
  - a) Amount invested in business by people other than the owner.
  - b) Amount invested by the owners in the business.
  - c) Loan obtained by the business from bank.
  - d) Loan obtained by business from government.
- ii. The accounting equation states that
  - a) Assets are equal to capital plus liabilities.
  - b) Assets are equal to capital minus liabilities.
  - c) Liabilities are equal to capital plus assets.
  - d) Capital minus liabilities is equal to assets.
- iii. Out of the following which is not an external liability of the business:
  - a) Outstanding rent
  - b) Bank loan
  - c) Capital
  - d) Outstanding salary.

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- iv. Out of the following which is an item of expenditure.
- Rent paid
  - Commission paid
  - Goods purchased
  - Furniture purchased
- v. Out of the following which is not an item of revenue:
- Sale of goods.
  - Rent received.
  - Sale of old furniture.
  - Commission received.

**WHAT YOU HAVE LEARNT**

- Capital : Amount invested by the owner(s) in the business:
- Drawing : Amount of cash or goods taken away by the owner for personal use.
- Liability : Obligations of the business.
- External Liabilities : Obligations or amount which the business owes to outsiders.
- Revenue : Inflow of money as a result of sale of goods or providing of services.
- Expense : Cost incurred in earning revenue.
- Expenditure : Amount spent for purchase of assets.
- Profit : Excess of revenue over expense.
- Loss : Excess of expense over revenue.
- Purchases : Acquisition of such goods or services in which the business deals.
- Sale : Exchange of merchandise either for cash or on credit to customer.
- Stock : Value of merchandise available for sale, work in progress in the manufacturing process, raw material.
- Debtors : Customers to whom goods have been sold on credit & from whom payment is to be received.
- Creditors : Suppliers of goods from whom goods have been purchased on credit and to whom payment is to be made.

**TERMINAL EXERCISE**

1. Define the following terms:
  - Capital
  - Drawings



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- iii. Debtors
- iv. Creditors
2. Define liability, revenue & expense.
3. What is meant by Double Entry Book Keeping?
4. Give any five examples of external liabilities.
5. With the help of examples give the meaning of internal and external liabilities.
6. Give two examples each of the following:
  - i. Creditors for goods;
  - ii. Creditors for expenses;
  - iii. Creditors for loans.



## ANSWER TO INTEXT QUESTIONS

- 3.1 I.** i) liability      ii) external, internal      iii) internal  
 iv) external      v) owner's equity/capital
- II.** i) external      ii) internal      iii) internal      iv) external  
 v) external      vi) internal      vii) external      viii) external  
 ix) external      x) internal
- 3.2 I.** i) revenue      ii) expense      iii) profit      iv) expenditure
- II.** i) revenue      ii) expense      iii) expense      iv) expenditure  
 v) revenue      vi) expense      vii) expenditure      viii) expense
- III.** i) asset      ii) expense      iii) expense      iv) liability  
 v) liability      vi) revenue      vii) capital      viii) asset  
 ix) asset      x) liability      xi) asset      xii) revenue  
 xiii) asset      xiv) expense      xv) revenue      xvi) asset
- IV.** i) b      ii) a      iii) c      iv) d      v) c

## ACTIVITY FOR YOU

- Visit a business organization in a nearby area and identify the different terms which you have studied in this chapter.

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## Success Stories



**Kavya Madhavan**  
**Enrolment No. 090008103065**

Kavya Madhavan is a highly acclaimed actress in the Malayalam film world. Making her debut as a child artiste, Kavya quickly managed to find a place in the hearts of Malayalees. However, all this was at the cost of dropping out of school at the Secondary level. Like many others, she too nurtured a dream of acquiring a college degree. Motivated to join the National Institute of Open Schooling (NIOS), Kavya Madhavan appeared for the Senior secondary level examination in Malayalam medium and emerged successful. But this was not achieved easily, she says.

Thanks to the Open Schooling system, Kavya Madhavan has now registered for B.Com in M.G. University, Kottayam, Kerala.



**Ganesh**  
**Enrolment No. Secondary Course: 25001292005**  
**Senior Secondary Course: 250012103570**

Ganesh has cleared the Secondary course of NIOS with first division and has now appeared in 4 subjects of Senior Secondary course. What differentiates Ganesh from other students is that he is suffering from a non-healing ulcer of bone infection. There is no treatment for his ailment; his lower part below the belt has not grown. The puss leaks from his body continuously. He cannot move, and even has no sensation in the lower part of his body. He has to be carried to be moved from one place to another.

However, support from his family members and the Chief Commissioner of Disabilities facilitated his enrollment as a student under Sarva Shiksha Abhiyan as a private candidate, thereby enabling him to clear Class 5 and Class 8. It was at this point that NIOS came to his rescue by providing the flexibility of studying at his own pace through credit accumulation. He could also study subjects of his own choice and was further allowed to appear for the examination in his house. UT Chandigarh continued to support him by providing him with the facility of tutors, who taught him Maths and Science.

With a keen interest in religion, he has read about the various *Puranas*, *Ramayana* etc., from which he has derived a lot of internal strength.

Ganesh is certainly determined to study further and wishes to pursue a course in Computer Science after clearing his Senior Secondary course from the NIOS.

## MODULE - II

Maximum Marks

25

Hours of Studies

60

### Journal and Other Subsidiary Books

This module will help the students to understand the rules of Debit and Credit and develop the skill of applying these rules in recording the transactions in journal and other subsidiary books. It will also help them in preparing the different subsidiary books such as Cash Book, Purchase Book, Sales Book, Purchase Return Book and Sales Return Book.

- Lesson 4** : **Accounting Equation**
- Lesson 5** : **Double Entry System**
- Lesson 6** : **Journal**
- Lesson 7** : **Cash Book**
- Lesson 8** : **Bank Reconciliation Statement**
- Lesson 9** : **Purchase and Sales Book**