INTRODUCTION TO ACCOUNTING

Introduction to Book Keeping, Accounting and Accountancy

- **Meaning of Book Keeping:**
  - According to R.N. Carter, "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."
  - It is a part of accounting and therefore, involves identification of financial transactions, measurement of such transactions in monetary terms, recording of such transactions in the books of account and classifying the transactions and events by way of posting them into individual Ledger Accounts.
- **Meaning of Accounting:**
  - According to American Institute of Certified Public Accountants, "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 result thereof."
  - Accounting is an art that records, classifies and summarises the financial transactions which helps in understanding the profitability and financial status of the business. It is also regarded as science as it is follows a structured knowledge base that requires effective compliance of the basic accounting concepts and principles.
- **Meaning of Accountancy:**
  - According to Kohler, "Accountancy refers to the entire body of the theory and practice of accounting."
  - It is a systematic knowledge of accounting which helps to deal with various aspects of accounting. In addition to this, it educates the users on how to maintain the books of accounts and to summarise the accounting information that is to be communicated to the users.
- **Understanding the relationship between Accounting and Accountancy:**
  - Accounting is a process and Accountancy is knowledge.
  - Accountancy frames rules and principles which are to be followed and complied in the Accounting process.
  - It is therefore said that accountancy is the knowledge of accounting and accounting is the application of accountancy.

- **Differences between Book Keeping and Accounting:**

Sr. no.	Basis	Book Keeping	Accounting
1	**Meaning and Scope**	It is a part of accounting, as it involves identification of financial transactions, measurement of such transactions in monetary terms, recording of such transactions in the books of account and classifying the transactions and events by way of posting them.	It 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 result thereof.

2	**Stage**	First stage of accounting and is therefore, considered as a basis of accounting.	Second stage, starts where Book Keeping ends.
3	**Purpose**	Purpose is to maintain systematic records of the financial transactions.	Purpose is to ascertain net results of operations and financial position of the enterprise so as to communicate information to the interested parties.
4	**Nature**	It is of routine nature.	It is analytical and dynamic in nature.
5	**Skills**	It is mechanical in nature and therefore, does not require special skills.	It requires special skills and ability to interpret the information effectively.
6	**Performed**	It is performed by junior staff.	It is performed by senior staff.

Introduction to Accounting

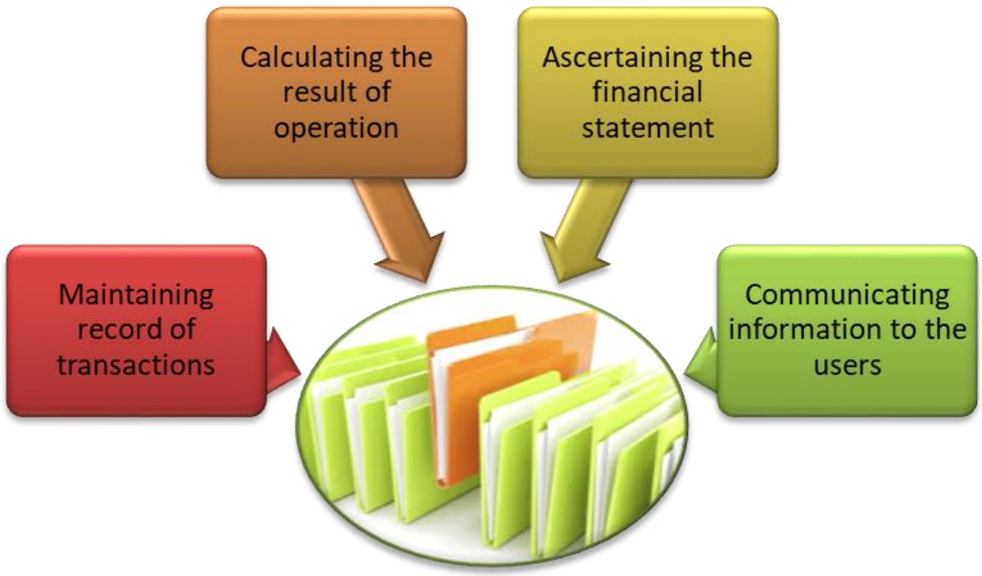
As per the American Accounting Association, “Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information.”

Characteristics, Objectives, Process and Branches of Accounting:

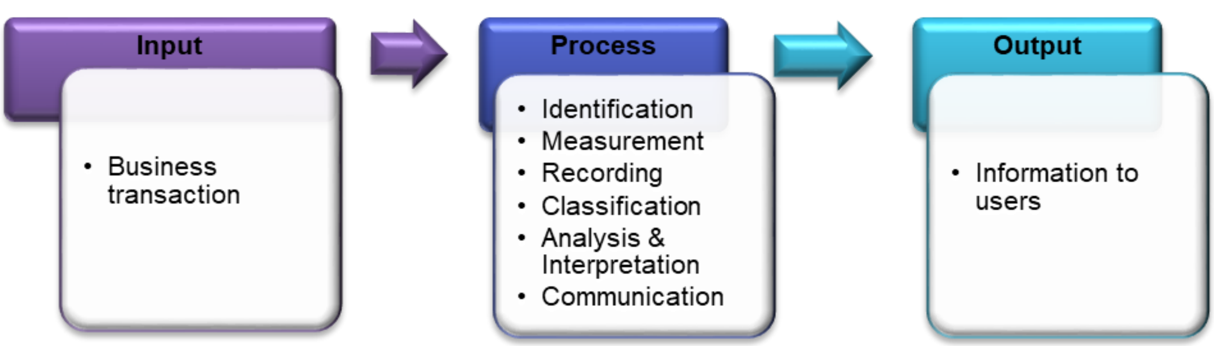
- **Characteristics or Attributes:**
    - **Identification of the economic events and financial transactions:** In order to record the transactions in the books of account, it is necessary to identify the transactions which are considered as a part of economic activity for the entity. This is done with the help of bills and invoices issued for the respective transactions.
    - **Measurement in terms of money:** In order to measure all the identified transactions and events in terms of a common measurement unit, all the transactions are to be measured in terms of money. This is because, accounting records only those transactions which are measurable in monetary terms.
    - **Recording of business transactions:** This is the process of entering the business transactions in the primary or original book of account i.e., Journal which is further divided into specific subsidiary books such Cash Book, Purchases Book, Sales Book, etc.
    - **Classification of business transactions:** It is the process of classifying the identified transactions or entries of similar nature at one place. This is done by posting the entries from the Journal to the respective Ledger Accounts under which all the transactions of similar nature are collected.
    - **Summarising business transactions:** This involves presenting the classified data in a manner that is useful and understandable to the users of financial statements. Summary is prepared by presenting the data in various statements like Trial Balance, Trading and Profit and Loss Account and Balance Sheet. These are collectively known as Final Accounts.
    - **Analysing and Interpreting the business transactions:** In order to make valuable judgments and financial decisions, the information presented in various statements is analysed and interpreted in a systematic manner.

- Communicating the results and conclusions to the interested users in the form of various statements: Involves communicating the valuable accounting information to the interested users so as to aid them in taking important decisions.

- **Objectives:**



  - It maintains a systematic record of all financial transactions in book of accounts.
  - It gives an idea about the net results of the business operation periodically. The owner of business organisation can ascertain the profit earned or loss incurred during an accounting period based on the records maintained.
  - It helps to determine the financial position of the business in terms of assets and liabilities on a particular date which is usually the last day of an accounting year. It also gives a proper account of assets held in the business and the liabilities due for payment.
  - It provides valuable information to the users in the form of reports, statements, graphs and charts.
  - It facilitates proper planning and effective decision making based on the detailed accounting information maintained.
  - **Accounting Process:** Steps involved in an accounting process are based on the attributes of Accounting which are presented below in the form of a diagram:



  - **Branches of Accounting:** Due to increased scale of business operations, the management function has become more complex now. We have specialized branches of accounting to handle these situations.

- **Financial Accounting:** This branch of accounting records financial transactions, summarises and interprets them to present and communicate the financial results and performance to the interested users.
- **Cost Accounting:** This branch of accounting takes into account all the business operations, processes or activities in order to ascertain the cost of products and simultaneously reduce and control costs.
- **Management Accounting:** This branch of accounting is said to address the needs of a single user group i.e., the management, as it enables the management to gather information relating to funds, costs, profits, etc. which enables them to take proper decisions.

Functions, Advantages, Role and Limitations of Accounting:

- **Functions:**
  - To maintain the accounting records in a *systematic and organised manner* so that it can be made available for any future purposes.
  - To *prepare the financial statements* for a particular period which correctly determine the arithmetical accuracy, profitability and financial position of an entity for a particular period of time.
  - To facilitate timely preparation and submission of forms, reports, etc. as are required to *comply with the provisions* of the Companies Act, Income Tax Act, GST Act, etc. These submissions can then be used as evidences in the court of law.
  - To *communicate correct financial information* to the users of the financial statements based on which correct financial and investment decisions can be taken by them.
  - To *assist the management* in maintaining the correct accounting records which helps them to improve their business performance and facilitate effective decision making for the organisation.

- **Advantages:**
  - *Financial performance* i.e., profit earned or loss incurred during an accounting period and the *financial position* at the end of an accounting period is clearly understandable from the accounting records.
  - Management is able to make *effective business plans* and take *appropriate decisions* related to the business affairs based on the recorded accounting information.

    - A systematic accounting record helps in *settlement of income tax* and *GST* liabilities because it is the evidence of the correctness of transactions.
    - Banks and financial institutions grant *loan* on the basis of the profitability trends and growth potential that is evident from the statements maintained by the organisation.
    - Records and statements maintained by the organisation can be used as *legal evidences* in the event of any scrutiny or investigations.
    - These records maintained are helpful in the *event of admission or retirement of partners* in case of a Partnership firm in order to distribute and allocate the respective shares to give effect to the adjustments made.

- **Role in Business:**
    - The primary and most important role of accounting information is to *maintain a systematic record of the business transactions* which are to be used in preparing financial statements and also in determining the profitability of the business over a period of time.
    - *It assists the management* of an entity by providing the required financial information which can be used in proper functioning and appropriate decision making for the organisation.
    - It provides systematic financial information over a period of time which facilitates *comparison* of the financial performance of one year with that of other years.
    - It is considered a valid *evidence in the court of law* in the event of a financial issue or case being filed.
    - It is maintained systematically in order to *avail financial loans* and advances in the near future.
    - It ensures that all the items are taken into consideration so that *correct tax liabilities* are determined. This facilitates timely payment of various taxes and duties and thereby avoid the interest and penalty charged thereon.

- **Limitations:**
    - **Accounting records are not fully correct:** Transactions are recorded in the books of account on the basis of source documents such as sale invoice, purchase invoice, receipt of cash etc. In case there is any mistake in these documents, the records maintained will also show incorrect information.
    - **Accounting does not consider any of the qualitative elements:** As accounting statements are confined to monetary values only, qualitative elements are ignored.
    - **Accounting ignores the price level changes:** Since, the accounting records are maintained at historical cost, the changes in the value of money are not considered while preparing financial statements. Unless price level changes are considered, accounting information will not present the original financial results.
    - **Accounting information may not be realistic:** Since the accounting records are maintained based on the accounting concepts and conventions, it is possible that the information may not be realistic.
    - **Accounting may be used to Window Dress the financial position:** In order to conceal the facts and present the financial statements in a better manner, books of account may be manipulated by using various tricks. In such case, the profitability is overstated and Balance Sheet does not give a true picture of its financial position.

Introduction to Accounting Information

Meaning, Types, Characteristics and Users of Accounting Information:

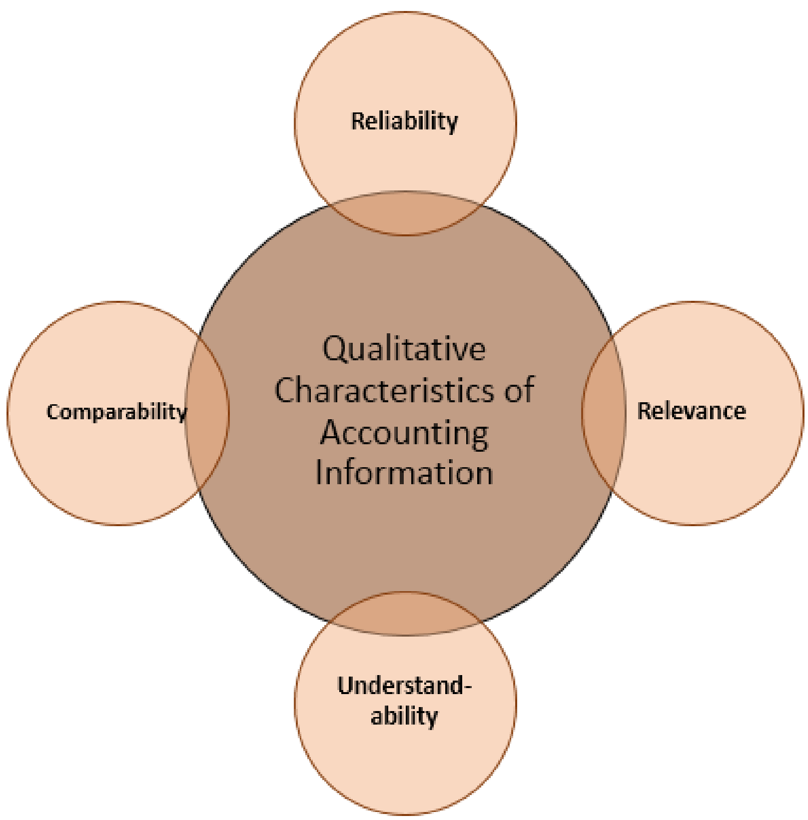
- **Meaning:**

- According to the Accounting Principle Board, "*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 information refers to the information in the financial statements prepared through the process of Book Keeping which helps the interested users to understand the profitability and financial position of the entity and take the appropriate financial decisions.

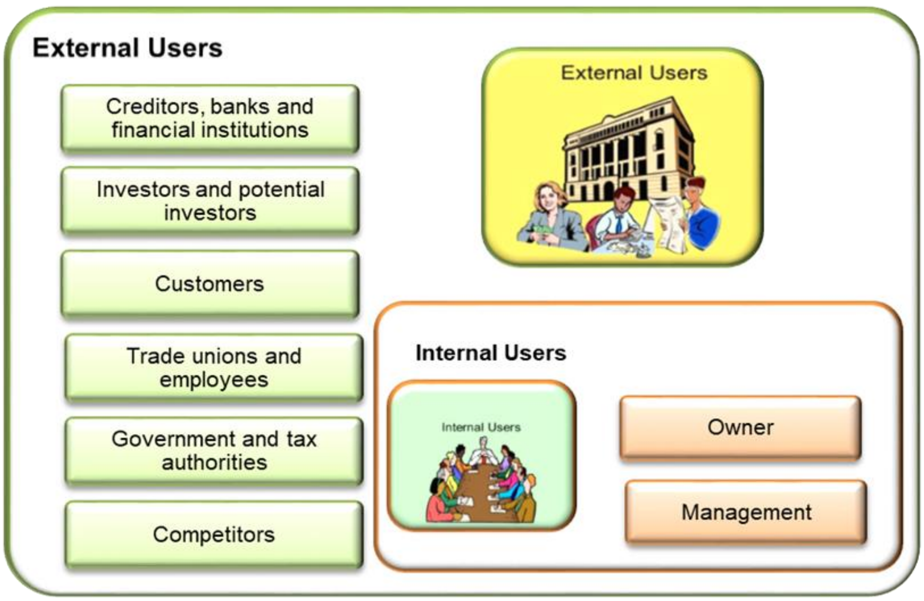
- **Types:** Accounting information available from the financial statements can be classified in the following types as information relating to:
  - **Profit or Surplus:** This is the information about the profit earned or loss incurred from the operating activities of the business entity during an accounting year.
  - **Financial Position:** This is the information about the asset owned, amounts receivable and the cash and bank balance owned by an entity. In addition to this, information about the liabilities owed by the entity is also covered under this head.
  - **Cash Flow:** This is the information about the cash inflows and outflows during a particular accounting period. Such information is used to take vital decisions like payment of dividend, expansion of business, etc.

- **Qualitative Characteristics:**



- **Reliability:** Accounting information should be verifiable and free from errors and any material error.
- **Relevance:** Accounting information should be relevant enough to meet the needs of the users and helps take some decisions.
- **Understandability:** Accounting information should be presented in such manner that it is understood by the users.
- **Comparability:** Accounting information should be such that it facilitates the intra-firm and inter-firm comparison.

- **Users:**



- **Internal Users:**
  1. **Owners:** These are those who contribute capital in the business. Since, they invest their money in the entity, they are interested in knowing the profits earned or losses incurred by the business which determines the returns they would earn on their investments.
  2. **Management:** They are the one who is responsible for the operations and decisions taken for the business entity. They are those who extensively use the accounting information to make decisions and plan further actions to improve the profitability of the operations.
  3. **Employees and workers:** These are those who are entitled to the salary, bonus, etc. which are directly linked to the profitability of the organisation. In order to determine whether the organisation is in a position to pay out such amounts, these employees and workers are interested to know the profitability and financial position of their organisation. Also, financial statements keeps them informed regarding compliance with various provisions related to the Provident Fund, Insurance, Gratuity, etc.

- **External Users:**
  1. **Creditors:** The parties who supply raw material/goods/services on credit based on the credibility and past experiences with that particular entity. In order to decide whether to supply anything on credit to a particular party or not, these creditors analyse the financial statements to determine the liquidity and solvency of that party to ensure timely payment for the supplies made on credit.

ii. **Banks and financial Institutions:** They provide timely financial assistance for the business activities in the form of loans, credit facilities, etc. In order to decide whether to sanction such financial assistance for a particular business, Banks and financial institutions analyse financial statements to satisfy themselves about the credit worthiness of the company and ensure timely repayment of loans and the interest thereon.

iii. **Investors and Potential Investors:** They do not have direct control on the business affairs and thus rely on the accounting information available in the financial statements. They are basically concerned about the returns earned on their investments. The profitability and earning capacity of the business is the only area of their concern.

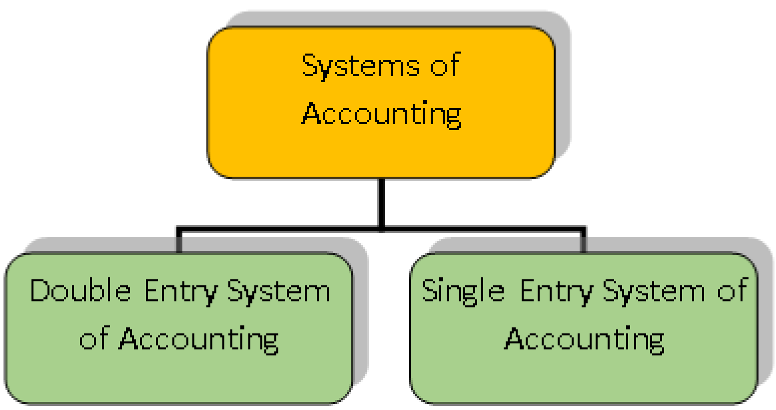
iv. **Customers:** Consumers or the users are concerned about the prices of the goods they buy and therefore, want to establish good accounting control so that the cost of production may be reduced with the resultant reductions in the prices of the products they buy.

v. **Government and tax authorities:** They use the financial information of the business to compile national income accounts and other information so as to take some policy decisions. Also, with the help of accounting information, it becomes clear if the business entity has complied all the necessary tax requirements related to excise duty, GST, income tax, etc.

vi. **Researchers:** They use the financial information in their research work and therefore, analysis and interpretation of the information in financial statements becomes necessary for such users.

vii. **Public:** They are interested in knowing the substantial contribution that an entity makes to the economy as a whole in terms of employment, development, etc. Accounting information helps them to understand such contribution towards the economy.

Introduction to Systems of Accounting



Understanding Meaning, Features, Stages and Advantages of Double Entry System:

- **Meaning:**
  - It is a complete system of recording transaction in the books of accounts.
  - Each transaction reveals two aspects:
    i. receiving or incoming or expenses/loss aspect known as debit aspect and
    ii. giving or outgoing or income/gain aspect known as credit aspect.

- **Features:**
  - It maintains a complete record of each transaction by recognizing two-fold aspect of every transaction i.e., the receiving and giving aspect.
  - It follows the rule of debit and credit and therefore, for every transaction, one aspect is debited and the other aspect is credited.
  - It ensures that for every debit there is a corresponding credit and therefore, at the end of a particular period the total of all debits will be equal to the totals of all credits which ensures the arithmetical accuracy of the records maintained.

- **Stages:**
  - Record all the financial transactions in the Journal.
  - Classify the recorded transactions by posting them to the appropriate ledger accounts.
  - Prepare a Trial Balance using the debit and credit balances of all the ledger accounts.
  - Close the books and prepare the final accounts comprising of the necessary statements.

- **Advantages:**
  - It is scientific system of recording transactions which helps in attaining the accounting objectives.
  - It is a complete record of transactions as it takes into consideration both debit and credit aspects of every transaction.
  - It ensures arithmetical accuracy of accounting records by preparing a Trial Balance.
  - It determines correct profit or loss for a particular accounting period by preparing Profit and Loss Account.
  - It provides correct information of the financial position of an entity on a particular date by preparing Balance Sheet on that date.
  - It facilitates comparison of an entity's financial performance over a period of time.
  - It assists the management in taking correct functional and financial decisions.
  - It helps in detecting errors and frauds and thereby prevents the wastage of resources.

Understanding Meaning, Features and Advantages Single Entry System:

- **Meaning:**
  - It is a simple form of book keeping and accounting in which each financial transaction is recorded with a single entry in a journal.
  - It does not record both the aspect of the transaction. It records single aspect of the transaction and therefore it is an incomplete system of recording financial transaction.
  - It maintains only personal accounts and cash book. The amount of each cash inflow or outflow is entered with the description of transaction.

- **Features:**
  - **Suitable for small-size business:** It is considered suitable for small-size business having less number of transactions.
  - **No Uniformity:** It is a mere adjustment to double entry system of accounting based on the requirements and convenience. Therefore, it may differ from firm to firm.
  - **Personal Accounts Only:** It maintains only personal accounts and ignores preparation of real and nominal accounts.
  - **Cash Book:** It maintains cash book which mixes the business and personal transactions.

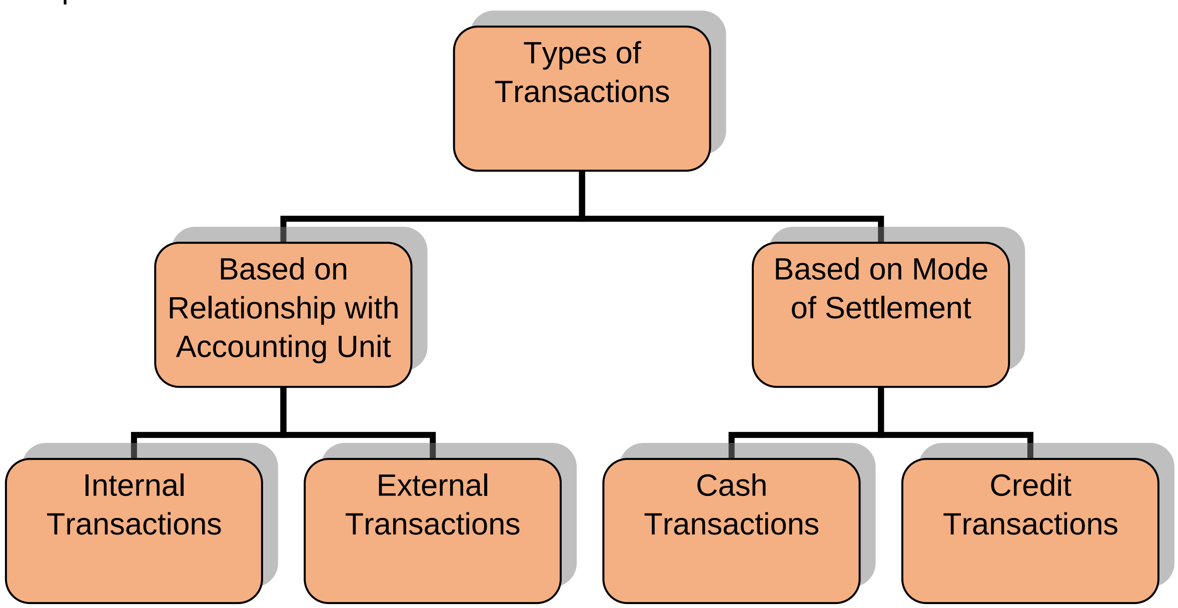
- **Information based on Vouchers:** It takes into consideration information available from the respective vouchers.
- **Difficult to prepare final accounts:** It is very difficult to prepare final accounts as no complete record is available to ascertain the correct profitability and determine the exact financial position of the entity.

- **Advantages:**
  - **Simple:** It is a simple method of maintaining books of accounts and therefore, ascertaining profit or loss also becomes very easy.
  - **Economical:** It does not require preparation of multiple accounts and statements and therefore, is a conventional and economical system of accounting.
  - **Less time consuming:** It records only one effect as there is no need to record the corresponding second effect and therefore, it is less time consuming.
  - **No expertise required:** Since, this method does not follow the prescribed concepts and conventions, expert knowledge and professional experience is not required to follow this system of accounting.

BASIC ACCOUNTING TERMS

Understanding Basic Accounting Terms

- **Business Transaction:**
  - **Transaction:** It is an event which involves transfer of money, goods and services and can be classified into cash or credit transactions. Cash transaction is the one where cash receipt or payment is involved and a credit transaction is one where cash is not involved immediately but will be paid or received later.



  - **Business Transaction:** It is a financial transaction or an economic event expressed in terms of money which brings in a change in the financial position of an enterprise. It involves transfer and exchange of goods or services such as purchase/sale of goods and services, wages paid to workers, rent paid, dividend received, lending and borrowing money.

  - **Characteristics:** Following are the characteristics of a Business Transaction:
    i. Money or money's worth: It is basically concerned with money or money's worth received from of sale of goods or provision of services.
    ii. Exchange of goods or services: It arises out of exchange of goods or services.
    iii. Change in financial position: It affects the financial statements of an enterprise and therefore, is responsible for change in its financial position.
    iv. Accounting equation: It affects the accounting equation of any business firm.
    v. Dual Aspects: Every business transaction has 2 sides, one is receiving side and the other is giving side and therefore, it is said to have a dual aspect for every transaction.
    vi. Equality of Balance Sheet: Since, every transaction has dual aspect affecting the two sides namely, Receiving and Giving simultaneously, it helps in maintaining the equality of Balance Sheet.

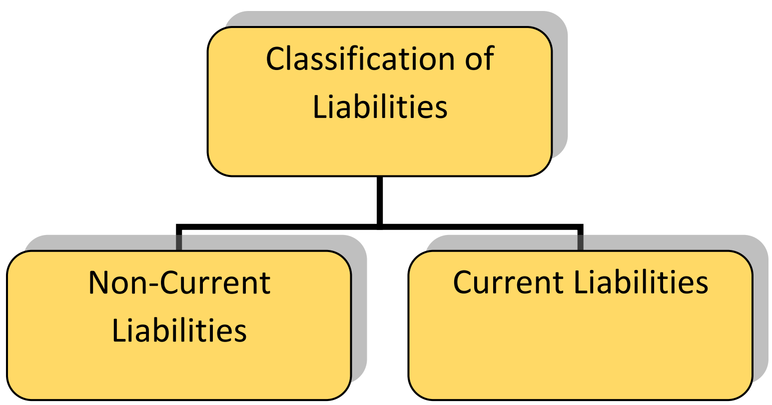
- **Account:** It is a record of both cash and credit transactions maintained under a particular head which shows the transactions and the effect of such transactions in the books of accounts.

- **Capital:** It is the amount invested by the proprietor (in case of proprietorship business) and by partners (in case of partnership business) into the business. If the business earns profit or proprietor/partners invests additional amount, the amount of capital increases in the business. On the other hand, if the business incurs losses or amount is withdrawn, the amount of capital decreases. Capital is also known as Owner's Equity or Net Worth which is computed as excess of Assets over Liabilities as follows:

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

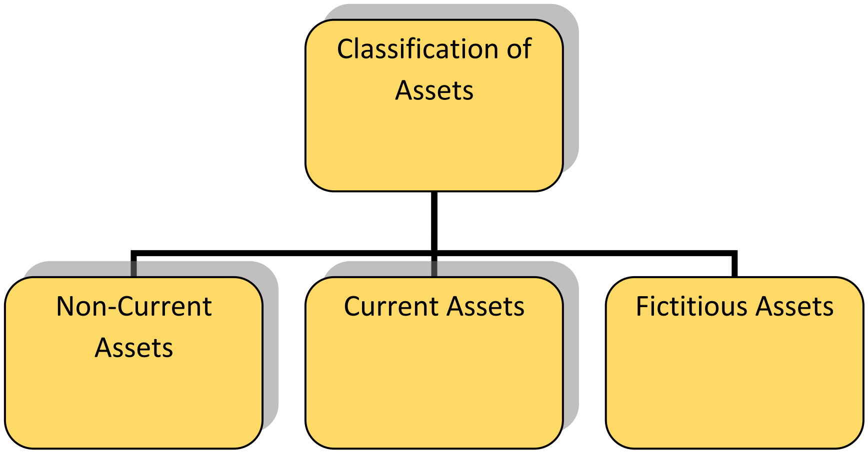
- **Drawings:** It is the amount of cash or goods withdrawn from the business by the proprietor (in case of proprietorship business) or by partners (in case of partnership business) for their personal use. Such an amount reduces the amount of investments or capital of the owners in the business and therefore, is shown as a deduction from the capital of the proprietor or partner while preparing the Balance Sheet.

- **Liabilities:** It refers to the financial obligations or debt which a business owes to others, i.e. amount business is liable to pay others such as loans from banks, other persons or creditors for goods supplied. These liabilities are classified as Internal or External Liabilities where, internal liability is the liability towards owners of the business and external liability is the liability towards the outsiders (i.e., other than owners). It is further classified as follows:



  - **Non-Current or Long term Liabilities:** These are the loans which are payable after a period of more than a year from the end of the accounting period. Examples include, long-term loans, debentures, etc.
  - **Current or Short term Liabilities:** These are the obligations which are payable within a period of 12 months from the end of the accounting period. Examples include, bills payable, short-term loans, etc.

- **Assets:** These are the properties owned by the business which are used to carry out the business operations and earn operating revenue for the business. It can be classified into Non-Current, Current and Fictitious Assets which are explained as follows:



- **Non-Current assets:** These are used for carrying out normal business operations and are held in the business not for the purpose of reselling it but to increase the earning capacity of the business. These are further classified as Fixed Assets, Non-Current Investments, Long term Loans and Advances and Other Non-Current Assets.
  - **Fixed Assets:** These are those assets which are not held in the business for reselling but are held for a long term to increase the earning capacity of the business. They are further classified as follows:
    - **a. Tangible:** Assets which have physical existence and can be seen and touched are termed as Tangible Assets. It includes land, building, furniture, etc.
    - **b. Intangible:** Assets which do not have physical existence and cannot be seen and touched are termed as Intangible Assets. It includes patents, goodwill, etc.
- **Current Asset**: These are those assets which are held on short term basis for the purpose of converting them into cash within a year such as debtors, stocks, etc. Prepaid expenses are also classified as current assets because although they cannot be converted into cash, because a part of their benefit is available for next accounting year.
- **Fictitious Assets**: These are those assets which are neither tangible nor intangible. These are the losses not written off in the year in which they are incurred but in more than one accounting period.

Receipts, Expenditure, Income, Expense, Profit, Gains and Losses

- **Receipts:** It is the amount which is received or receivable for selling goods, services or assets. These receipts are further classified as follows:
  - **Revenue Receipts:** The amount that has been received or is receivable by the business in its normal course either from sale of goods or by providing services. It will also include the amounts that are received from investment of business resources say interest received from investment in fixed deposits. Such amounts from normal course of business are recorded in the Profit and Loss Account (in case of profit-making enterprises) and in the Income and Expenditure Account (in case of an NPO).
  - **Capital Receipts:** The amount received or receivable against the transactions which are not revenue in nature like sale of an asset, investment, etc. Such amounts are shown in the Balance Sheet of the business entity.

- **Expenditure:** It is the amount spent or liability incurred for acquiring assets, goods or services. These expenditures are further classified as follows:
  - **Revenue Expenditure:** It is that expenditure the benefit of which is consumed or exhausted within the accounting period. These are the amounts spent for the purposes which are directly

related to the business of the entity like cost of goods sold, rent, electricity, etc. They are shown in the Trading or Profit and Loss Account (in case of profit-making enterprises) and in the Income and Expenditure Account (in case of an NPO).
    - **Capital Expenditure:** It is the amount incurred to acquire tangible or intangible assets or the amount spent on improving the existing assets which increase the earning capacity of the business. These amounts spent are shown in the Balance Sheet of the entity.
    - **Deferred Revenue Expenditure:** This is a revenue expenditure in nature which is written off or charged in more than one accounting period. Such treatment is given to those items, the benefits of which are estimated to accrue in more than one financial year. These include the large expenditure amounts like advertising expenses, research expenses, etc. that will give benefit for more than one accounting period.

- **Income:** It is the profit earned during an accounting period which is calculated as the difference between the Revenue and Expenses. In other words, excess of Revenue over expenses is termed as Income.

- **Expense:** It is the cost incurred for generating revenue or a monetary measure of inputs or resources consumed. It is actually the value of business that has expired during the accounting year. It includes amount spent as cash payments for salaries, wages or amounts that are written off during an accounting period like depreciation, bad debts or decline in the value of any investment or cost of goods sold. It is charged to the Trading Account or Profit and Loss Account. It is necessary to understand the following expenses:
    - **Prepaid Expenses:** It is the amount of expense which is paid in advance and the benefit of which will be available in the following year or years and therefore, are shown as assets in the Balance Sheet of the business.
    - **Outstanding Expenses:** It is an expense that has been incurred but has not been paid during the current accounting year. Since, the amount is payable, it is a liability for the business and is therefore, shown as a liability in the Balance Sheet.

- **Profit:** It is the income earned by the business from its Operating Activities which are carried out by the enterprise to earn profits. These activities can be either sale of goods or provision of services. This profit is further divided into gross and net profit:
    - Gross Profit: It is the difference between revenue from sales and/or services rendered and its direct cost.
    - Net Profit: It is the profit after deducting total expenses from total revenue of the enterprise. In case if the total expenses are more than the total revenue, such difference is termed as Net Loss.

- **Gain:** It is the increase in the owners’ equity resulting from something other than the day to day earning that is of irregular or non-recurring nature. It is the profit from non-operating transactions but which is incidental to it such as gain on sale of land, machinery or investments.

- **Loss:** Loss refers to the excess of expenses over its related revenues for a period which decreases the owners’ equity. It is a broad term and includes loss incurred in its operating activities, money or money’s worth lost against which the firm receives no benefit, or any loss from events of non-recurring nature.

Purchases, Purchases Return, Sales, Sales Return, Revenue from Operations, Goods and Stock/Inventory

- **Purchases:** It refers to the amount of goods which are bought for resale or the amount of raw materials that are used in the production process. It includes both cash and credit purchases of goods.
- **Purchases Return:** When goods are returned to the suppliers for any reason, it is called as purchases return or returns outward.
- **Sales:** Sales refers to the amount of goods sold that have already been bought or manufactured by the business. It includes both cash and credit sales of goods.
- **Sales Return:** When goods are returned from the customers for any reason, it is called sales return or return inward.
- **Revenue from Operations:** Revenue means the income generated from the sale of goods (in case of a non-financial enterprise) and the earnings from interest, dividend and commission (in case of a financial enterprise). In other words, it is revenue earned by an enterprise from its operating activities.
- **Goods:** These are the physical items of trade that are purchased to be sold and includes all the items making up the sales or purchases of a business. In other words, it is actually Stock-in-trade of an enterprise, purchased or manufactured with the purpose of selling.
- **Stock/Inventory:** Stock or Inventory is a tangible asset that is held by the business for the purpose of sale in normal course of business or for the purpose of using it in production of goods meant for sale. It includes goods unsold on a particular date. It may be opening or closing stock. The goods unsold in the beginning of the accounting period is called opening stock, whereas the goods unsold at the end of the accounting period is called closing stock.

Trade Receivables, Trade Payables, Cost, Vouchers, Trade Discount and Cash Discount

- **Trade Receivables:** It is the amount that is receivable for sale of goods and/or services rendered in the ordinary course of business. It is a sum total of debtors and bills receivable.
  - **Debtor:** Includes a person who receives a benefit without paying money immediately but liable to pay in future within a particular period of time. He owes an amount to business against credit sale of goods/services rendered.
  - **Bills Receivable:** It is the amount of Bill of Exchange accepted by a debtor specifying the amount of which will be received on the specified date from him by the business.
- **Trade Payables:** It is the amount payable for purchase of goods and/or services taken in the ordinary course of business. In other words, it is the sum total of creditors and bills payable.
  - **Creditor:** A creditor is a person who gives a benefit without receiving money immediately but to claim it in future. It is to whom our business owes an amount against credit purchases of goods/services.
  - **Bills Payable:** It is the amount of Bill of Exchange accepted by the person or enterprise, the amount of which will be payable on the specified date.
- **Cost:** It is the amount incurred on or attributable to a specified item or activity in the business.
- **Vouchers:** A voucher is a written document in support of a particular transaction. It includes, cash memo as given by the seller for cash purchase, invoice given for credit purchase and received receipt for making cash payment.
- **Discount:** It is the amount of reduction in the price of goods and/or services or a reduction in the total amount payable for such goods or services. Such discount is further classified as Trade Discount and Cash Discount:
  - **Trade Discount:** It is a reduction in the prices of the goods allowed by the seller to the buyer for buying goods of certain quantity or value. When such discount is allowed, Purchases and

Sales are recorded in the books at their net value i.e., Purchases – Trade Discount and Sales – Trade Discount respectively.

  - **Cash Discount:** It is allowed for timely payment of the amount. Such amount is recorded in the books for which it is treated as an expense by the party allowing such discount and income by the party receiving such discount.

Other Important Terms

- **Bad Debts:** It is the amount receivable by the business which becomes irrecoverable and is therefore, treated as a loss by the business and debited to the Profit and Loss Account.
- **Balance Sheet:** It is a statement of financial position of a business on a particular date, which shows the assets, liabilities, capital reserves and other account balances at their respective book values.
- **Book Value:** It is the value at which the items (assets, liabilities, etc.) appear in the books of accounts or financial statements.
- **Books of Account:** It is the records or books in which all the financial transactions of an entity are recorded and maintained. It includes journal, ledger, cash book and bank book.
- **Cost of Goods Sold:** It is the cost attributable to the production of goods sold and/or services rendered.
- **Debit:** It is the left side of an account and is derived from an Italian word 'Debito'. In case where an account is to be debited, the entry is posted to the debit side of an account and it is said that the account is debited.
- **Credit:** It is the right side of an account and is derived from an Italian word 'Credito'. In case where an account is to be credited, the entry is posted to the credit side of an account and it is said that the account is credited.
- **Depreciation:** It is a fall in the value of an asset on account of usage or passage of time or obsolescence. It is allocation of cost of the fixed asset in each accounting year during its expected useful life.
- **Entity:** It is an economic unit which carries out various economic activities and is established in accordance with the law in force. It includes proprietorship, partnership firms, corporations, companies, etc.
- **Entry:** It is a transaction or an event which is recorded in the books of account.
- **Insolvent:** It is the state of a person/entity where he is unable to pay its debts.
- **Proprietor:** A person who owns a business and contributes capital to the business to earn profit is called proprietor.
- **Rebate:** It is a reduction in the price of the goods after the goods have been sold and is offered for reasons other than that which may have been for allowing trade discounts (say, bad quality products delivered). It is offered and allowed on sales completed in the past.
- **Solvent:** It is the state where a person/entity is in position to pay of its debts.