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ACCOUNTING TERMS

5.1 INTRODUCTION

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 terms. The entire structure of Accounting rests upon these terms. The terms, that we frequently use, are Assets, Liabilities, Revenue and Expenses.

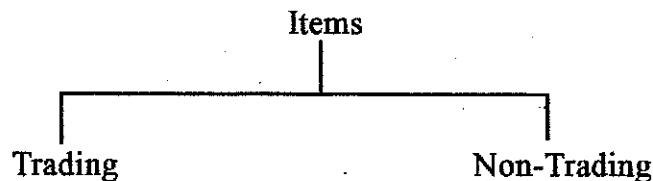
5.2 OBJECTIVES

After studying this lesson, you will be able to:

- classify the items into Trading and Non-trading items;
 - state the meaning of the term 'Asset' and enumerate the different assets used in business;
 - distinguish between current and non-current (fixed) assets;
 - state the meaning of the term 'Liability';
 - state the meaning of the terms Revenue and Expense with example;
 - differentiate between expense and expenditure.
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5.3 TRADING AND NON-TRADING BUSINESS ITEMS

You must have visited many business concerns. You might have noted the various items that are purchased for further sale by the business concerns. You might have also noted various other items that are used in the business concern and which are not meant for sale. For example, in a stationery shop, there are various items like books, pens, pencils, scales, note-books, charts, gum bottles, etc. These items are purchased by the businessman in order to sell them. There are certain other items like fan, Air-conditioner, generator, furniture, etc. in the stationery shop. These items are purchased by the businessman for use and not for sale. From the above examples, we can classify all the items in a business concern into two categories, viz, trading and non-trading.



a) Trading items

Trade means purchase and sale of goods or/and services. All goods or items which are purchased by the businessman in order to sell the. thereby earn profit are called **Trading items**. A business concern deals in trading items. In the stationery shop, books, pens, pencils, etc are all trading items.

b) Non-Trading items

Items which are purchased by the business concern in order to use them are called as **Non-Trading items**. These items are not meant for sale. In the stationery shop, furniture, fan, generator, etc. are non-trading items. Like the stationery shop, other business units also possess **Trading and Non-Trading items**. For example, for a cloth merchant, different varieties of cloth are trading items and racks made to store and display the cloth are non-trading items. For a transport company, buses are trading items because they provide service and the sheds (place where buses are kept) and tools kept to repair the buses are non-trading items.

INTEXT QUESTIONS 5.1

From the following lists of business concerns, you are required to name one trading item and one non-trading item.

| Business concern | Trading items | Non-trading items |
|-------------------------------|---------------|-------------------|
| i. Toy manufacturing unit | | |
| ii. Furniture showroom | | |
| iii. Birla Transport company | | |
| iv. Bata shoe store | | |
| v. Raymond's Textile showroom | | |

5.4 ASSETS

All trading and non-trading items purchased by a business concern are of *value*. These items are purchased for use or for future benefits. Hence these items, broadly, fall under the category of assets.

Assets refer to the items of value which are owned by a business concern. The amount spent by the firm in order to acquire these valuable items is also part of the assets. All tangible items and intangible rights carrying future benefits are also assets. Tangible items are those which can be touched and their presence can be noted, e.g.-furniture, machines, etc.. Intangible rights are those rights which one possesses but cannot see e.g. copyrights, patent rights, etc. Assets are purchased for *business use* and *are not meant for sale*. They increase the profit earning capacity of the business concern. All non-trading items are assets and the trading items which remain unsold with the business concern at the end of the year are called as closing stock or stock-in-trade. They are also placed in the category of assets

There are various assets used in business. They are cash in hand, cash at bank, land, buildings, furniture, machinery, money owed by others (debtors), goodwill, patent rights, expenses paid in advance or pre-paid

expenses, bills receivable, investments, income yet to be received or accrued income, tools, stock-in-trade, etc.

Assets are broadly classified into two categories :

- a) Current Assets
- b) Non-Current Assets
- a) Current Assets

Current assets are those assets which are held for short time generally a year's time only. The balance of these assets usually, keep on changing. For example, the balance of cash in hand may change so many times during the day. The various current assets are cash in hand, cash at bank, debtors, bills receivable, stock, prepaid expenses.

- b) Non-Current Assets

Non-current assets are those assets which are acquired for long term use in the business. These assets increase the profit earning capacity of the business. Expenditure on these assets is not regular in nature. The expenses incurred in acquiring these assets are added to the value of the asset. For example, a machine has been purchased by the Hindustan Company. The company pays transportation charges and carriage to transfer the machine to its factory. Hence, transportation and carriage costs are expenses for the company which are added to the cost of the machine. Examples of other assets are land, building, furniture, machinery, vehicles, etc. These assets are used for a long period and are not converted into cash within a year.

INTEXT QUESTIONS 5.2

1. Fill in the blanks with suitable words :
 - a. Items of value owned are called.....
 - b. Assets are not meant for
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- c. The balance of assets which keep on changing is called asassets.
- d. Assets acquired for long-term use are called asassets.

II. Classify the following items into current and non-current assets:

- (i) Furniture
- (ii) Cash at bank
- (iii) Machinery
- (iv) Debtors
- (v) Stock
- (vi) Land
- (vii) Building
- (viii) Prepaid expenses
- (ix) Vehicles
- (x) Cash in hand

5.5 LIABILITIES

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 paid.
- Creditors for loans** — Bank loan, Bank overdraft, partner's loan, loans taken from other outsiders.

(ii) Internal Liabilities

Internal liabilities are those liabilities which the business owes to the owners 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 out 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:

- (i) Capital
- (ii) Interest on capital
- (iii) Profits of the business

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

INTEXT QUESTIONS 5.3

- I. Fill in the blanks with suitable words:
- a. Outsider's and owner's claim against the assets of the firm is called
 - b. Liabilities are classified into two categories and
 - c. Owner's claim is liability.
 - d. Outsider's claim is liability.
 - e. 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
 - (iii) Capital
 - (iv) Sundry creditors
 - (v) Outstanding rent
 - (vi) Profits
 - (vii) Bills Payable
 - (viii) Bank overdraft
 - (ix) Salaries due but not paid
 - (x) Reserves
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5.6 REVENUE AND EXPENSE

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 refers to the amount which, as a result of operations, is added to the Capital. It is the amount realised 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 realised. 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.

EXPENSE

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.

EXPENSE AND 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.

INTEXT QUESTIONS 5.4

- I. Fill in the blanks with suitable words :
- Inflow of money is called as
 - Outflow of money is called as
 - Expense is incurred in order to earn
 - Money spent in order to purchase assets is called as
- II. From the following information, identify the revenues, expenses and expenditure.
- Rent received
 - Salaries paid
 - Cost of raw material
 - Furniture purchased
 - Commission received
 - Insurance premium paid
 - Machines purchased
 - Advertising cost
- III. Classify the given items into assets, liabilities, capital, revenue and expense.
- Stock-in-hand
 - Rent paid
 - Advertising
 - Creditors
 - Outstanding expense (rent)
 - Interest received
 - Capital introduced

- h. Furniture and Fittings
 - i. Insurance Premium Prepaid
 - j. Commission Received in Advance
 - k. Debtors
 - i. Dividend received
 - m. Cash at Bank
 - n. Salaries Paid
 - o. Discount Received
 - p. Land and Building
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5.7 WHAT YOU HAVE LEARNT

1. Trading items are those items which are purchased by the businessman in order to earn profits.
2. Non-trading items are purchased for further use and not for sale.
3. Assets refer to items of value owned by a firm
4. Outsider's claims and proprietor's claims against the assets of the firm are liabilities. Proprietor's claim is called capital.
5. Revenue is inflow of money from the sale of goods and services provided
6. Expense refers to costs incurred in order to earn revenue.
7. Expenditure refers to costs incurred to acquire the assets.

5.8 TERMINAL QUESTIONS

1. Answer the following questions in one sentence:
 - (i) What is expense?
 - (ii) what is liability?

2. Answer the following questions in 30-50 words
 - a. Distinguish between trading and non-trading items.
 - b. State the meaning of the term 'Asset' with examples.
 - c. Distinguish between expense and expenditure.
3. Define the term 'Liability'. Distinguish between external and internal liabilities. Explain how Capital is also a liability (100-150 words).
4. Explain current and non-current assets. Give two examples of each (100-150 words).

5.9 ANSWERS TO INTEXT QUESTIONS

- 5.1
1. Toys, furniture
 2. Table, fan
 3. Buses, shed
 4. Shoes, show-cases
 5. Cloth, furniture

Note: For each of the above questions, other suitable examples may also be given.

- 5.2
- I. (a) assets, (b) sale (c) current; (d) non-current
 - II. (i) non-current
 - (ii) current
 - (iii) non-current
 - (iv) current
 - (v) current
 - (vi) non-current
 - (vii) non-current

- (viii) current
 - (ix) non-current
 - (x) current
- 5.3 I. (a) liabilities
- (b) external and internal
 - (c) internal
 - (d) external
 - (e) capital
- II. (i) external
- (ii) internal
 - (iii) internal
 - (iv) external
 - (v) external
 - (vi) internal
 - (vii) external
 - (viii) external
 - (ix) external
 - (x) internal
- 5.4 I (a) revenue
- (b) expenses
 - (c) revenue
 - (d) expenditure
- II. (a) revenue
- (b) expense

- (c) expense
- (d) expenditure
- (e) revenue
- (f) expense
- (g) expenditure
- (h) expense

III

- (a) asset
 - (b) expense
 - (c) expense
 - (d) liabilities
 - (e) liabilities
 - (f) revenue
 - (g) capital
 - (h) asset
 - (i) asset
 - (j) liabilities
 - (k) assets
 - (l) revenue
 - (m) asset
 - (n) expense
 - (o) revenue
 - (p) asset
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