# St. Lawrence High School

A Jesuit Christian Minority Institution

Study Material 7

Sub: ACCOUNTANCY Class 11

Chapter: Unit 1: Introduction to Accounting Date: 07/07/2020

Topic: Basic Accounting Terms 3

**Basic Accounting Terms**

**Profits:**

Profit is the difference between two varying factors, sale price and cost. The wider gap between these two, wider is the amount of profit. A firm is always after profit maximization. Therefore, profit can be increased either by increasing sales price or by reducing cost. Except for a monopolist, it is not possible to increase the selling price of a product. The firm has to accept the price prevailing in the market. In effect, emphasis is on the cost of reduction. Again, to reduce the cost of a product, one has to know the exact meaning of the word 'cost' and what are the elements of cost.

**Losses:**

A loss is an excess of expenses over revenues which may arise from normal business activities. A loss is a prima facie evidence that business activity is being conducted unsuccessfully. Losses may also arise from events largely beyond the control of the firm and of non-recurring nature and can result from the following:

(a) Sale of assets, other than inventories, for less than their book value.

(b) Decline in the current value of inventories.

(c) Diminution or elimination of assets due to accidental causes like food, fire, etc.

(d) Settlement of liabilities in excess of book value, e.g. , debentures issued at par, redeemable at a premium.

(e) Involuntary insurance of liabilities, e.g., as a result of law suit.

**Purchases:**

Purchases refer to the buying of goods for resale or for use in manufacturing process. Purchases, therefore, mean for a trader, what he buys for reselling. For a manufacturer, purchases mean purchase of raw materials which he converts into finished goods. The purchases for an accounting period show the total purchases which include both cash and credit purchases. The total of purchases is an important element in the calculation of cost of goods sold.

**Sales:**
Sales are the total value, at selling prices, of the goods and services sold by the business unit during a period of time. Sales of a business unit may take one of the two forms: cash or credit. Sales appear as the first item in the trading account. The total sales credited to the trading account is the aggregate of cash and credit sales. Most sales represent, the normal, ongoing transactions of the enterprise. The total reported showed, therefore, include only receipts from regular operation of the firm.
In accounting, sales are recognized as income at the point of a sale or at the performance of a service. The point at which the sales is made depends upon the terms of contract between the buyer and the seller. But the sale is complete when the goods are delivered by the seller and being accepted by the buyer. Thus, in recognizing sales as income, there is no need to wait until the money is received.

**Stock:**
Stock is an asset which can reasonably be accepted to be sold by a business unit. It is a collection of physical materials held by the business unit to support the flow of the activities. Stock is the inventory of raw materials, work-in-progress and finished goods. A trader will maintain stock of finished goods so that customers can be supplied on demand. A manufacturer will maintain a stock of raw materials so that customers can be supplied on demand. A manufacturer will maintain a stock of raw materials so that continuity of production will not be held up while fresh are awaited. Stock is classified on the balance sheet as a current asset. It is recorded at its cost or net realizable value, whichever is lower.

**Debtors:**
Debtors are amount owed to the business unit generally by its customers arising out of credit sales. In most cases, the debtors of a business unit arise when goods are supplied to the customers on credit and are to be paid for an agreed future time. A business unit's management of debtors is very important. It ties up large amount money and run the risks of bad debts.
Debtors form an important component of working capital, and are classified as current assets in a balance sheet.

**Creditors:**
A creditor is one to whom a business unit owes money. Most businesses use credit to purchase goods and services. Credit is allowed for a period of time to purchases of goods or services before payment for them is required. Creditors are therefore, those to whom monies are due for the delivery of goods or services on credit.
In balance sheet, creditors are classified as current liabilities. In effect, it is a component of working capital.

**Bills Receivable:**
When a bill of exchange is written out, it is called 'drawing' of a bill. A bill of exchange from the view point of the drawer or holder of the bill is called Bills Receivable because the money is receivable by him at some time in future. It helps temporary settlement of a debt between a debtor and a creditor without involving cash. It can be discounted with bank or it can be endorsed in favour of a creditor to pay a debt. It is shown in the balance sheet as a asset.

**Bills Payable:**
A bill of exchange from the view point of the drawee is called bills payable because money is payable by him at some time in future. It helps the creditors to pay a debt without immediate outflow of cash. It is shown in the balance sheet as a current liability.

**Goods:**
Goods are physical items of trade. It is a general term which applies to all items making up the purchases or sales of a business unit. Therefore, goods are items in which a business enterprise deals in. A business enterprise purchases goods either for resale, or as a raw material to be converted into finished product.

**Cost:**
In accounting cost is an expenditure made to acquire goods or services that can be produced revenue. Since the cost of a thing is that which is given or to be given to acquire that, a cost always represents as an asset. In cash transactions, the amount of money paid, or promised to be paid to acquire a thing, is its cost. Generally, a cost is an amount which is always related to some object or unit.

**Gain:**
A gain is an increment in wealth that arises from anything other than revenues. A gain is always of an irregular or non-recurring nature. Gain arises from peripheral or incidental transactions. Generally, gains result from such activities as sale of investments, disposition of fixed assets, the settlement of a liability at less than its book value, the winning of a lawsuit and the like.

**Voucher:**
The voucher is a document which provides the authorization to pay and specifies the accounts to be debited and credited. It contains all written evidence.

**Discount:**
A discount is a reduction in the price of goods below the amount at which those goods are generally sold to other customers. It is the difference between a face value and the lower amount paid or received. There are different types of discount such as:
(a) Trade discount
(b) Quantity discount
(c) Cash discount
(d) Settlement discount

**Trade Discount:**
Trade discount represents the allowance which is made by the manufacturer to the wholesaler or by the wholesaler to the retailer and it is calculated as a percentage of list or catalogue prices of goods supplied. Between traders, trade discount represents the profit the buyer will make by reselling the goods.

**Cash Discount:**

Cash Discount is allowed to encourage a debtor to pay-off his debt within a specified period. If the debtors settles his account within a given time period, he is entitled to reduce his bill by the agreed amount. The invoice sent by the suppliers or to the customers will usually contain details of cash discount.

Prepared by
Pralay Kabi