St. Lawrence High School

A Jesuit Christian Minority Institution

Study Material 5

Sub: ACCOUNTANCY Class 11

Chapter: Unit 1: Introduction to Accounting Date: 03/07/2020

Topic: Basic Accounting Terms 1

Basic Accounting Terms

Business Transactions:

A transaction is a particular type of external event, which can be expressed in terms of money and brings change in the financial position of a business unit. A transaction involves transfer of something value between two or more entities. A transaction may be an exchange in which each party receives as well as sacrifices values. In other words, in every transaction, there is a movement of value from one source to another.

A transaction can also be a non-reciprocal transfer in which a business unit incurs a liability or transfer of asset to another party or receives an asset or cancellation of liability without directly receiving value in exchange. Transaction may be external or internal.

Meaning of Event:

Event is an occurence, happening, change or incident, which may or may not bring any change in the financial position of a business unit. It may be an internal event that occurs within a business unit, e.g., using new materials in production, death of the general manager or threat by a labour union to call a strike. It may be an external event that involves interaction between a business unit and its environment, e.g., change in the price of a product that the business unit buys or sells, or an improvement in the technology by a competitor.

Account:

An account is a formal record, in the ledger, of all transactions relating to changes in a particular item. It is used to convey information or transaction. Similar type of transactions are gathered at one place in an account. Account is the basis of recording transactions in the books of account. At the time of recording transaction under double entry system one account is debited and another account is credited. Sometimes, one group of accounts are debited and another group of accounts are credited.

Capital:

Capital is the amount of money invested by the owner in his business. The money is spent to buy things which the business unit needs to carry on its trade. For example, capital may be used to buy buildings and machinery. In accounting, what a business is worth is called capital. It is the difference between total assets and total liabilities of the business unit. Capital can be brought in by a person into the business in different form – cash or kind. When the capital is brought in the form of cash, it is spent on various items of assets that make the business a going concern.

The capital of a business can be increased when the owner –

(i) brings in more capital to the business unit; and/or

(ii) does not withdraw the entire profit for an accounting period.

When the owner brings in further capital to his business, the amount is credited to the Capital Account. Likewise the net profit for an accounting period is credited to the Capital Account. If the drawings are less than net profit, the capital is increased by the difference.

Drawings:

Drawings are assets of a business unit. Drawings thus appear in the accounts of sole traders and partnerships. Drawings are generally made in anticipation of profits.

Since withdrawal of cash reduces the owners capital it could be recorded by debiting Capital Account. Generally a separate account is opened called Drawings Account to record all withdrawals by the owner. Debit to the Drawings Account are required for any of the following transactions:

(a) withdrawals of cash for personal use.

(b) withdrawals of goods for personal use.

(c) payments of the owner’s personal bills out of business cash/bank

Liabilities:

Liability is a legal obligation expressed in terms of money, which arises from transactions or other events that have already occurred. It involves an enterprise in a probable future transfer of cash, goods or services or the forgoing of a future cash receipt.

A liability arises because of credit transactions. Most goods and services may be purchased by a business unit on credit. Fund may be borrowed from commercial banks for working capital purposes. Large sums are provided by debenture issues to finance new building and machinery.

The liabilities of a business unit must be fully recognized and properly measured in the balance sheet. The amount of liability and the date of settlement of such liability are the claims of the outsiders against the business. Liabilities are stated in the balance sheet as the amount of cash ultimately payable.

According to modern approach, liabilities of a business are classified into:

(a) Non-Current liabilities

(b) Current liabilities

If duration of a liability is more than one year is known as non-current liability. If duration of a liability is for one year is known as current liability.

Assets:

Assets are those resources that the business owns. They refer to some property or legal right owned by a business unit, which can be measured in terms of money.

Assets can be defined as probable future economic benefits obtained or controlled by a particular business unit as a result of past transactions or events. Future economic benefits refer to the capacity of an asset to benefit the business unit by being-

(i) Exchange for something else of value to the business unit.

(ii) Used to produce something of value to the business unit.

(iii) Used to settle its liability.

According to the modern approach, assets of a business are generally classified into

(a) Non-current assets

(b) Current assets

If an asset is used in the business for more than one accounting year is known as non-current asset. If an asset is used in the business for an accounting period is known as current asset.

Examples of non-current assets:

Land, Building, Plant, Machinery, Furniture etc.

Example of current assets:

Debtors, Stock, Bank Balance, Cash in hand, Bills Receivable, Prepaid Expenses etc.

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