CHAPTER-2 - Basic Accounting Terms

Short Question

Question 1

The terms related to accounting used in the daily functioning of companies across the globe are known as basic accounting terms. Such terms are universal, so as to ease financial conversations globally.

Question 2

Three examples of revenues are as follows:

(i) Money received from sale of goods and services

(ii) Money received for rent, commission, interest, etc.

(iii) Money received from sale of assets

Question 3

Profit refers to the excess of revenues over expenses in a financial year, occurring from the normal functioning of the business. On the other hand, gain refers to the money earned from events occurring beyond the normal functioning of the business, like sale of assets, etc.

Question 4

Fixed assets refers to those assets that have been purchased for utilization in the business for a long period of time and are not purchased to sell them. On the other hand, current assets are those assets which a company purchases for the purpose of resale and converting them into liquid cash within 1 accounting cycle.

Question 5

Revenue expenditure are the expenses whose benefits are realized completely within a year from incurring it. On the other hand, capital expenditure are the expenses whose benefits are realized for more than a year since incurring it.

Question 6

Expenditure refers to the monetary amount spent on the acquisition of assets, goods, services, etc. On the other hand, expenses are a sub set of expenditure, which refers to the cost incurred in the production and sale of goods and services.

Question 7

Expenses refers to the money spent and whose benefits have been realised within a year. On the other hand, loss is the short fall of revenues as compared to expenses incurred.

Question 8

Two characteristics of a business transaction are as follows:

(i) It impacts the change in value of assets/ liabilities/ capital, thereby impacts and changes the financial positon of the firm.

(ii) All business transactions have a monetary value, and can be expressed in terms of a currency.

Very Short Question

Question 1

The capital refers to the money introduced by the proprietor of the business which can be in cash, assets, etc. Capital can be either owned money or borrowed money.

Capital = Assets - Liabilities

.**Question 2**

If any cash or goods is drawn by the proprietor for personal use, is considered as a drawing and is debited from his/her capital account. Such withdrawals are known as drawings.

Question 3

The amount a company owes to external parties is known as a liability. Owners of the company are not included in this category.

Question 4

Any physical, tangible or intangible object/ item owned/ purchased under the company's name is known as the company's asset. It also includes any amount due from external parties to the company.

Question 5

Current assets refer to those assets that are meant to be liquidated within a period of 1 accounting cycle.

Question 6

Two examples of current assets are:

1. Cash in hand
2. Bills Receivable

Question 7

Two examples of tangible assets are:

1. Factory building
2. Inventory

Question 8

Two examples of intangible assets are:

1. Goodwill
2. Patents

Question 9

Fictitious assets are those assets which cannot be liquidated nor can any more benefits be realized from those assets. Such assets are recorded on the debit side of the Profit and loss A/c. An example of this type of asset is Advertising expenses.

Question 10

Current liabilities refer to those liabilities that a business has to pay and clear within an accounting cycle (generally).

Question 11

Two examples of current liabilities are:

1. Sundry creditors

2. Bills Payable

Question 12

Any money that the company owes to the owners of the company is known as internal liability. Examples of internal liabilities are capital, retained earnings, etc.

Question 13

Expense refers to the money utilized in the production and sale of goods and services from end to end.

Question 14

Revenue refers to the money generated in a recurring manner from the normal conduct of business which includes from the sale of goods and services.

Question 15

Income refers to the excess of revenue generated over expenses incurred in an accounting cycle.

Question 16

A voucher is a source document, based on which transactions are first recorded in the journal.

Question 17

Trade discount is a discount which is never recorded in the books of accounts and is allowed to a customer at a fixed percentage on the list price of goods.

Question 18

Cash discount is a discount which is always recorded in the books of accounts and is allowed to a customer when payment is made in a prompt and complete manner.

Question 19

Purchase refers to the buying of raw materials for production, or goods for resale for cash or credit.

Question 20

Sales refers to the revenue generated by the sale of company goods and services for either cash or credit.

Question 21

The goods that a company produces and sells is also known as merchandise.

Question 22

The profit should be transferred to the capital reserve, as the profit generated from the sale of assets is a capital profit.

Question 23

Two examples of revenue expenditure are:

1. Machinery Maintenance
2. Office Rent

Higher Order Thinking Skills (HOTS) Questions

Question 1

The machine purchased with the intention to resell will be considered as a good for the company, whereas the machinery purchased for production purposed will be treated as a fix asset.

Question 2

Revenue of a company refers to the money generated from both cash and credit sales, irrespective if amount has been received or not. Therefore, the Revenue will be ₹8,00,000 (i.e. 20TV sets X ₹40,000 each).

Question 3

Mr. Dinanath who owed the company Rs. 50,000, paid only Rs. 20,000 (40%). The remaining Rs.30,000 (60%) will be considered as bad debts for the company, i.e. the money will not be realised and is a loss.

Question 4

A few basic accounting terms are:

- **Business Transaction-** Any financial transaction occurred under the company's name is considered to be a business transaction. Such business transactions have a direct impact on the company's financial position.
- **Account-** The place where all transactions pertaining to one single person/ asset/ liability, etc. are recorded is known as an account. Every item that impacts the financial position via a transaction has a separate individual account maintained to record all transactions pertaining to it.
- **Capital-** The capital refers to the money introduced by the proprietor of the business which can be in cash, assets, etc. Capital can be either owned money or borrowed money.

Capital = Assets - Liabilities

- **Drawing-** If any cash or goods is drawn by the proprietor for personal use, is considered as a drawing and is debited from his/her capital account.
- **Liability-** The amount a company owes to external parties is known as a liability. Owners of the company are not included in this category.
- **Assets-** Any physical, tangible or intangible object/ item owned/ purchased under the company's name is known as the company's asset. It also includes any amount due from external parties to the company.

Value-Based Questions

Question 1

By the process of classifying assets as either current or non-current, the company is easily able to assess its liquidity position as well as classify assets based on permanence and thereby charge depreciation, forecast volume of production, etc. with much more ease.

Question 2

The weightage of classifying into capital receipts and revenue receipts is that it plays an essential role in assessing in computing financial statements of a company as revenue receipts are posted on the credit side of the profit and loss account whereas capital receipts are posted in the company balance sheet.

Question 3

The preparation of financial statements without the classification of expenditure into capital expenditure and revenue expenditure would not be accurate in nature. Revenue expenditure are posted on the debit side of the profit and loss account whereas capital expenditure is posted in the company balance sheet.

Question 4

Capital expenditures are shown in the balance sheet as this is an expenditure to acquire fixed assets which will benefit the organization over a long period of time, with no intention to sell the asset. Therefore, by posting it on the balance sheet, it is shown as an asset of the business.