

Accounting Terms

Gain/Monetary Benefit



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**Definition of Gain:**

A gain refers to a monetary benefit, profit, or advantage that arises from events or transactions which are not part of the primary operations of a business. Gains are typically considered incidental to the core business activities and can result from various types of transactions, such as the sale of fixed assets, winning a legal case, or an increase in the value of an asset.



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**Characteristics of Gains**

- **Incidental to Business Operations:** Gains are not generated from the main activities of the business. For instance, a retailer's primary revenue comes from selling goods, but a gain might come from selling an old delivery truck at a profit.
- **Non-recurring:** Gains often result from non-recurring events. They are not expected to happen regularly or frequently.
- **Monetary Benefit:** Gains result in a financial increase, either through cash inflow or an increase in the value of assets.



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**Examples of Gains:**

- **Sale of Fixed Assets:** When a company sells an asset like machinery, equipment, or buildings at a price higher than its book value, the difference is recorded as a gain.

Example: A building was purchased for Rs. 5,00,000. If the building is later sold for Rs. 6,00,000, the gain on sale is Rs. 1,00,000 (i.e., Rs. 6,00,000 - Rs. 5,00,000).



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- **Winning a Court Case:** If a company wins a lawsuit and receives a financial settlement, the amount received can be considered a gain, provided it is not related to the company's regular operations.

Example: A company wins a court case and receives a compensation of Rs. 50,000. This amount would be recorded as a gain.



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- **Appreciation in Asset Value:** If an asset owned by the company increases in value over time and is revalued or sold at a higher price, the increase in value is considered a gain.

Example: A company owns land that was initially purchased for Rs. 2,00,000. Over the years, the market value of the land appreciates to Rs. 3,00,000. If the land is revalued, the appreciation of Rs. 1,00,000 is recognized as a gain.



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Stock or Inventory:

**Definition of Stock or Inventory**

In accounting, the term "stock" or "inventory" refers to the goods and materials a business holds for the purpose of resale or production. These goods can be in various stages of completion and are a crucial component of a company's current assets.

**Types of Stock**

Stock can be broadly categorized into two main types based on the timing within the accounting period:

- Opening Stock: This refers to the value of goods that are unsold and carried over from the end of the previous accounting period to the beginning of the current accounting period.
- Closing Stock: This refers to the value of goods that remain unsold at the end of the current accounting period. This stock is carried forward to the next accounting period as opening stock.

**Types of Inventory in Manufacturing**

For a manufacturing business, inventory can be further divided into three specific types based on the stage of production:

**Stock of Raw Materials:**

- Definition: These are the basic materials that are purchased for use in the production process but have not yet been used.
- Example: In a textile manufacturing company, cotton would be considered raw material. The value of the unused cotton at the end of the period represents the stock of raw materials.

**Stock of Work-in-Progress (WIP):**

- Definition: This represents goods that are in the process of being manufactured but are not yet complete. These semi-finished goods need further work before they can be sold as finished products.
- Valuation: To value WIP, the cost of raw materials used, the cost of labor, and other manufacturing expenses (like power, fuel) on a proportionate basis are included.
- Example: In a textile mill, threads and unfinished cloth that are partially processed would be classified as WIP.

**Stock of Finished Goods:**



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- Definition: These are goods that have completed the manufacturing process and are ready for sale but have not yet been sold.
- Example: In a textile mill, finished cloth that is ready for sale but remains unsold at the end of the accounting period would be considered finished goods.

### Purchases

**Definition of Purchases:**

In business accounting, the term "purchases" specifically refers to the acquisition of goods that a business intends to resell as part of its core operations. The nature of these goods depends on the type of business:

- Manufacturing Concern: For a manufacturing business, "goods" refer to raw materials purchased for conversion into finished products. The finished products are then sold to generate revenue.
- Trading Concern: For a trading business, "goods" are items bought for direct resale without any further processing.

**Purpose of Purchases:**

The primary purpose of purchasing goods in both manufacturing and trading businesses is to generate profit through resale. This involves:

**Manufacturing Concern:**

- Purchases: Acquiring raw materials.
- Conversion: Processing raw materials into finished products.
- Sale: Selling the finished products to customers.
- Profit: The profit is made on the difference between the cost of raw materials, manufacturing expenses, and the selling price of the finished goods.

**Trading Concern:**

- Purchases: Buying goods ready for resale.
- Sale: Selling the goods to customers.
- Profit: The profit is the difference between the purchase cost and the selling price.

**Purchase Returns**

Purchase Returns, also known as Return Outwards, occur when the purchased goods are returned to the supplier. This can happen for various reasons such as:

- Defective or damaged goods.

- Incorrect goods delivered.
- Surplus goods that are not needed.

The value of purchase returns is subtracted from the total purchases to calculate the net purchases.

### Accounting for Purchases and Purchase Returns

In accounting, purchases and purchase returns are recorded in specific accounts to track the movement of goods and the expenses related to acquiring them.

### Example Scenario

Let's illustrate the concepts with a manufacturing business example:

#### Manufacturing Concern Example:

#### Purchases of Raw Materials:

Initial Purchase: The business purchases raw materials worth Rs. 1,00,000.

Purpose: These raw materials will be converted into finished products.

#### Purchase Returns:

- Returned Goods: Out of the purchased raw materials, goods worth Rs. 10,000 are found to be defective and returned to the supplier.
- Net Purchases Calculation:
- Net Purchases = Total Purchases – Purchase Returns
- = Rs.1,00,000 – Rs.10,000 = Rs.90,000

#### Trading Concern Example:

#### Purchases for Resale:

Initial Purchase: The business purchases ready-to-sell goods worth Rs. 50,000.

Purpose: These goods are intended for direct resale.

#### Purchase Returns:

- Returned Goods: Goods worth Rs. 5,000 are returned due to damage.
- Net Purchases Calculation:
- Net Purchases = Total Purchases – Purchase Returns
- = Rs.50,000 – Rs.5,000 = Rs.45,000

### Sales and Sale Return

#### Definition of Sales

In business, the term "sales" refers to the revenue generated from selling goods and services. It is important to distinguish between different types of sales:

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**Goods for Resale:**

- Definition: These are items that a business buys with the intention of reselling them to customers.
- Examples: A retail store selling clothes, a grocery store selling food items.

**Services Provided:**

- Definition: This includes revenue from services offered to customers as part of the business operations.
- Examples: Consulting services, repair services, legal advice.

**Sales Returns**

Sales Returns, also known as Return Inwards, occur when customers return previously purchased goods. Reasons for returns can include:

- Defective or damaged goods.
- Incorrect or wrong items delivered.
- Customer dissatisfaction with the product.
- Surplus goods that the customer doesn't need.

**Accounting for Sales and Sales Returns**

Sales and sales returns are recorded in the business's financial statements to provide a clear picture of revenue and the impact of returns on total sales.

**Example Scenario:**

Let's illustrate these concepts with an example of a retail business:

**Retail Business Example:**

**Sales Transactions:**

- Goods Sold: A retail store sells clothes worth Rs. 1,00,000 during a month.
- Services Provided: The store also offers alteration services and earns Rs. 10,000 from these services.
- Total Sales=Goods Sold + Services Provided
- =Rs.1,00,000+Rs.10,000=Rs.1,10,000

**Sales Returns:**

- Returned Goods: Customers return clothes worth Rs. 5,000 due to various reasons.
- Net Sales Calculation:
- Net Sales = Total Sales – Sales Returns = Rs.1,10,000 – Rs.5,000 = Rs.1,05,000

**Loss and Profit in Business Accounting**

**Loss:** The term "loss" in business accounting can convey two different meanings:

- **Operating Loss:** This occurs when a company's total expenses exceed its total revenues over a specific accounting period.
- **Non-Operating Loss:** This can refer to losses incurred from activities not related to the primary operations of the business, such as the sale of an asset at a loss or extraordinary events like natural disasters.

**Operating Loss**

- **Definition:** An operating loss happens when the total expenses of running the business (cost of goods sold, salaries, rent, utilities, etc.) are greater than the revenue generated from sales and other primary business activities.
- **Example:** If a company has total revenues of Rs. 1,00,000 and total expenses of Rs. 1,20,000, it incurs a loss of Rs. 20,000 for that period.

**Calculation:**

Loss = Total Revenues – Total Expenses

In this case:

Loss = Rs. 1,00,000 – Rs. 1,20,000 = –Rs. 20,000

**Non-Operating Loss**

- **Definition:** Non-operating losses are losses that arise from activities not related to the core business operations. These can include:
- **Asset Sales:** Selling an asset for less than its book value.
- **Extraordinary Events:** Losses due to unexpected events such as lawsuits, natural disasters, or obsolescence of inventory.
- **Example:** A company sells a piece of machinery for Rs. 30,000 that had a book value of Rs. 50,000. The loss on the sale is Rs. 20,000.

**Profit:** Profit is the financial gain when total revenues exceed total expenses over a specific accounting period. It is a key indicator of a business's financial health and performance.

**Types of Profit**

**Gross Profit:**

- **Definition:** Gross profit is the difference between sales revenue and the cost of goods sold (COGS). It indicates how efficiently a company is producing and selling its products.

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- Calculation:  $\text{Gross Profit} = \text{Sales Revenue} - \text{COGS}$

Operating Profit:

• Definition: Operating profit, also known as operating income, is the profit earned from a firm's core business operations, excluding deductions of interest and tax.

- Calculation:  $\text{Operating Profit} = \text{Gross Profit} - \text{Operating Expenses}$

Net Profit:

• Definition: Net profit, also known as net income or bottom line, is the total profit of a company after all expenses, including operating expenses, interest, taxes, and any other costs, have been deducted from total revenue.

- Calculation:  $\text{Net Profit} = \text{Total Revenue} - \text{Total Expenses}$

Example of Profit Calculation

Consider a business with the following details for an accounting period:

Sales Revenue: Rs. 2,00,000  
COGS: Rs. 1,20,000  
Operating Expenses: Rs. 50,000  
Interest and Taxes: Rs. 10,000

Gross Profit Calculation:

$\text{Gross Profit} = \text{Sales Revenue} - \text{COGS} = \text{Rs.}2,00,000 - \text{Rs.}1,20,000 = \text{Rs.}80,000$

Operating Profit Calculation:

$\text{Operating Profit} = \text{Gross Profit} - \text{Operating Expenses} = \text{Rs.}80,000 - \text{Rs.}50,000 = \text{Rs.}30,000$

Net Profit Calculation:

$\text{Net Profit} = \text{Operating Profit} - \text{Interest and Taxes} = \text{Rs.}30,000 - \text{Rs.}10,000 = \text{Rs.}20,000$

**Voucher**

A voucher is a document which provides the authorization to pay and on the basis of which the business transaction are, first of all, recorded in the books of accounts.

A separate is prepared for each transaction and it specifies the accounts to be debited or credited.

The form of a voucher varies from firm to firm since vouchers are printed separately by different firms in their own names. Vouchers are prepared by accountant and each voucher is numbered and countersigned by an authorized person of the firm.

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Discount and Types

**Discount:** it is a rebate given by the seller to the buyer. it is of two types:

Trade Discount

- Definition: A trade discount is a reduction in the listed price of goods or services offered by a seller to its customers. It is typically expressed as a fixed percentage of the list price.
- Purpose: The primary purpose of a trade discount is to encourage large or repeat purchases from the seller. It is often used in business-to-business (B2B) transactions and wholesale markets.

**Characteristics:**

- Not Recorded in Books: Trade discounts are not recorded in the books of accounts as they are deducted directly from the invoice or cash memo issued to the customer.
- Applied Before Sale: Trade discounts are applied before the sale is made, reducing the gross value of goods or services.

**Example:** If the list price of a product is Rs. 1,000 and the seller offers a 10% trade discount, the customer will only pay Rs. 900 for the product.

Cash Discount

- Definition: A cash discount, also known as a prompt payment discount or settlement discount, is a reduction in the purchase price offered by the seller to the buyer in exchange for prompt payment.
- Purpose: Cash discounts incentivize customers to make payments early, improving the seller's cash flow and reducing the risk of late or non-payments.

**Characteristics:**

- Recorded in Books: Cash discounts are always recorded in the books of accounts, as they represent a reduction in the actual amount received by the seller.
- Applied After Sale: Cash discounts are applied after the sale is made, based on the terms agreed upon between the buyer and seller regarding the payment period.

**Example:** If a seller offers a 2% cash discount for payment within 10 days, a customer who pays within the specified time period will only pay 98% of the invoice amount.

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Business transaction

A business transaction refers to any economic activity or event that directly impacts the financial position of a business. These transactions are the building blocks of the financial statements and are crucial for the accurate representation of a company's financial health.

Categories of Business Transactions

**External Transactions:** These involve an exchange between the business and an external party.

Examples: Selling products to customers, purchasing raw materials from suppliers, obtaining a loan from a bank.

**Internal Transactions:** These occur within the business and do not involve outside parties.

Examples: Allocation of internal resources, depreciation of assets, transfer of materials from one department to another.

Examples of Business Transactions

**Sales:**

- When a business sells products or services, it increases its revenue and cash or receivables.

- E.g., A retail store sells merchandise for Rs 1,000 cash. The cash account increases by Rs 1,000, and revenue increases by Rs 1,000.

**Purchases:**

- Buying goods or services for business operations increases expenses and may decrease cash or increase payables.

- E.g., Purchasing office supplies for Rs 200 on credit. Supplies account increases by Rs 200, and accounts payable increases by Rs 200.

**Borrowings:**

- Obtaining a loan increases both cash (or bank) and liabilities.

- E.g., Taking a Rs 5,000 loan from the bank. Cash increases by Rs 5,000, and loans payable (a liability) increases by Rs 5,000.

**Payments:**

- Paying off debts or expenses decreases cash and liabilities or increases expenses.

- E.g., Paying rent of Rs 500. Cash decreases by Rs 500, and rent expense increases by Rs 500.

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### Investments by Owners:

- Owners investing in the business increase cash and equity.
- E.g., An owner invests Rs 10,000 in the business. Cash increases by Rs 10,000, and owner's equity increases by Rs 10,000.

### Drawings in Business

#### Definition:

Drawings refer to any cash or goods withdrawn by the owner of a business for personal use. This also includes any private payments made out of business funds. Essentially, drawings represent the personal use of business resources by the owner.

#### Characteristics of Drawings

##### Reduction in Owner's Equity:

- Drawings decrease the owner's equity in the business. They are not considered business expenses but are distributions of profit.
- The owner's capital account is debited to reflect the reduction in equity.

##### Non-Business Use:

- Drawings are strictly for personal purposes and do not relate to the business's operations or expenses.
- Examples include withdrawing cash for personal needs, taking inventory for personal use, or using business funds to pay for personal expenses such as home utilities or personal travel.

##### Not Tax-Deductible:

- Since drawings are not business expenses, they are not tax-deductible. They do not affect the business's net profit but reduce the capital.

### Going Concern Concept

#### Definition:

The going concern concept is a fundamental accounting principle that assumes a business will continue to operate indefinitely, or at least for the foreseeable future. This assumption means the business is not expected to liquidate or cease operations soon.

#### Importance of the Going Concern Concept

##### Investor and Creditor Confidence:



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- The going concern assumption provides confidence to investors and creditors that the business is stable and capable of continuing its operations.
- Financial statements prepared under this concept provide a true and fair view of the business's financial position and performance.

**Decision-Making:**

- Managers rely on the going concern assumption for long-term planning and decision-making.
- It influences investment, financing, and operational decisions, ensuring they align with the business's ongoing activities.

Accounting Period Concept

**Definition:**

The accounting period concept divides the continuous life of a business into specific time intervals for the purpose of financial reporting. This allows the business to measure its financial performance and position periodically, typically on an annual basis.

**Examples of Accounting Periods**

**Annual Period:**

- A company follows the financial year from April 1, 2023, to March 31, 2024.
- At the end of this period, the company prepares its annual financial statements, including the income statement, balance sheet, and cash flow statement.

**Quarterly Period:**

- A company reports its financial performance quarterly, covering periods such as:
  - Q1: April 1 to June 30
  - Q2: July 1 to September 30
  - Q3: October 1 to December 31
  - Q4: January 1 to March 31

**Monthly Period:**

- Some businesses may prepare monthly financial statements to closely monitor their financial activities and promptly address any issues.

