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Definition of Accounting

Accountancy is the science of recording and reporting business information. It has a known history of more than 500 years. Luca Pacioli in his book '*Summa de arithmetica, geometria, Proportioni et proportionalita*' identified the system in vogue among merchants of Venice for recording transactions. There has, however, been little change in the system till late 1950s.

In 1941, the **American Institute of Certified Public Accountants (AICPA)** defined accounting as an art in following terms:

> "The art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions, and events which are, in part at least, of financial character, and interpreting the results thereof."

By 1966, the **American Accounting Association (AAA)** broadened the definition to emphasize its utility for decision-making and the ‘art’ became ‘process’ in following terms.

> "The process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of information."

In 1970, the **Accounting Principles Board of AICPA** highlighted the practical function of accounting, defining it as:

> "Providing quantitative information, primarily financial in nature, about economic entities, intended to be useful in making economic decisions."

Digital revolution and accountancy: With the rise in digitisation of records and need for frequent and instant business information the accountancy has taken a broader shape. Now accounting information is the backbone of the information and control system of an organisation. Transparency and standardisation have pushed the accounting process to the stage of science of accountancy. The principles of accountancy have been turned into digital logic. The only drawback, however, is that rules of accounting are now defining the rules of business.

Analysis of the definition of accounting

Relevant aspects of the definition of accounting are:

- Economic events
- Identification, Measurement, Recording and Communication
- Organisation
- Interested Users of Information

Economic events - An economic event is known as a happening of consequence to a business organisation which consists of transactions and which are measurable in monetary terms.

External events involve transactions between an outsider and an organisation; whereas **internal events** involve transactions between the internal wings of an enterprise.

Identification, measurement, recording and communication - **Identification** means determining what transactions are to be recorded. It involves observing activities and selecting those events that are of considerable financial character and relate to the organisation. **Measurement** means quantification of business transactions into financial terms by using monetary unit. **Recording** means noting down the transactions in the books of account of the organisation. It is done in a manner that the necessary financial information is summarised as per well-established practice and is made available as and when required. **Communication** means sharing of accounting information of the organisation to its internal and external users.

Organisation - Organisation refers to a business enterprise, whether for profit or not-for-profit motive.

Interested users of information - Users have an interest in assessing the financial performance and the position of an enterprise, planning and controlling business activities and making necessary decisions from time to time. They can be divided into two broad categories: internal users and external users. **Internal users** are those who are involved in planning and controlling the business activities. **External users** are those who interested in assessing the financial performance and position of an enterprise.

So, key components of accounting include:

1. **Economic Events:** Activities with financial implications measurable in monetary terms.

2. **Processes:** Encompassing identification, measurement, recording, and communication of financial data.
3. **Organization:** Serving as the central entity around which accounting practices are structured.
4. **Stakeholders:** The users of financial information, including managers, investors, creditors, and regulatory bodies.

Qualitative aspects of accounting information

In order to assess whether accounting information is useful for decision making, it must possess the characteristics of reliability, relevance, understandability and comparability.

Reliability means the users must be able to depend on the information. The reliability of accounting information is determined by the degree of correspondence between what the information conveys about the transactions or events that have occurred, measured and displayed. A reliable information should be free from error and bias and faithfully represents what it is meant to represent. To ensure reliability, the information disclosed must be credible, verifiable by independent parties, use the same method of measuring, and be neutral and faithful.

Relevance means the information must be available in time and must influence the decisions of users by:

(a) helping them form prediction about the outcomes of past, present or future events; and/or

(b) confirming or correcting their past evaluations.

Understandability means decision-makers must interpret accounting information in the same sense as it is prepared and conveyed to them. The qualities that distinguish between good and bad communication in a message are fundamental to the understandability of the message. A message is said to be effectively communicated when it is interpreted by the receiver of the message in the same sense in which the sender has sent.

Comparability of the information is equally important such that the users are able to compare various aspects of an entity over different time period and with other entities. To be comparable, accounting reports must belong to a common period and use common unit of measurement and format of reporting.

Role of Accounting

The role of accounting has continuously evolved to meet the demands of economic growth and shifting societal expectations. Accounting is the systematic process of measuring, classifying, and summarizing an organization's financial data to create meaningful reports and statements. These outputs provide insights into the financial condition and operational outcomes of a business, which is why accounting is often referred to as the "language of business."

Beyond its reporting function, accounting serves as a crucial support activity by offering quantitative financial data that assists stakeholders in making informed decisions. It collects, processes, and communicates economic information to various internal and external users, enabling them to evaluate performance, plan strategies, and manage resources effectively.

Despite its broad applications, accounting is primarily focused on past financial transactions and delivers quantitative, monetary information. It does not account for qualitative or non-financial data, such as employee satisfaction or environmental impact.

Recognizing these limitations is essential when relying on accounting information for decision-making.

Modern Insights

Recent advancements in technology and accounting practices have addressed some of its traditional limitations:

- **Integration of Non-Financial Metrics:** Modern accounting systems increasingly incorporate environmental, social, and governance (ESG) metrics to reflect an organization's broader impact.
- **Real-Time Reporting:** Digital tools and automation enable real-time data analysis, providing more timely and actionable insights for decision-makers.
- **Predictive Analytics:** Advanced software now supports forecasting and scenario planning, bridging the gap between historical data and future trends.

Accounting as an information system

Accounting is a structured process involving interconnected steps that begin with identifying financial transactions and culminate in the preparation of financial statements. Each step in this process generates valuable data. However, the generation of accounting information is not the final goal; its primary purpose is to communicate this data to various stakeholders. By making this information accessible, accounting plays a critical role in enabling users to make informed decisions. Disseminating accurate and timely financial information is, therefore, one of the core functions of accounting.

To ensure its effectiveness, accounting information must:

- **Facilitate economic decision-making:** Provide relevant insights to help users assess options and take appropriate actions.
- **Serve as a reliable resource:** Offer dependable data for stakeholders who depend on financial statements as their main source of financial insights.
- **Support cash flow predictions:** Provide information that aids in evaluating the timing, amount, and uncertainties of future cash flows.
- **Evaluate resource management:** Enable stakeholders to assess how efficiently management utilizes resources to achieve organizational objectives.
- **Disclose assumptions and context:** Present factual and interpretative information that clarifies the basis for predictions, estimates, and evaluations.
- **Highlight societal impact:** Share information that reflects the organization’s broader social and environmental activities, catering to a growing emphasis on sustainability and corporate responsibility.

In today’s digital age, accounting systems are increasingly leveraging automation and analytics to enhance the timeliness and accuracy of the information provided. This shift enables businesses to offer real-time insights, which are crucial for decision-making in fast-changing environments.

Stakeholders interested in accounting information

Accounting information is essential for various stakeholders to assess a business's performance and make informed decisions. The primary users of this information include:

- **Owners and Investors:** Owners and investors use accounting information to evaluate the profitability of the business and understand its financial health. They are interested in knowing the return on their investment and assessing the performance of the management if the business is not self-managed. This helps them make informed decisions about continuing, expanding, or withdrawing their investment.
- **Managers:** Managers rely on accounting information to plan and control business operations. This information assists them in setting financial goals, monitoring progress, and making strategic decisions to improve performance. It also helps them identify areas needing corrective actions and in resource allocation for maximum efficiency.
- **Lenders and Creditors:** Lenders, such as banks and financial institutions, use accounting data to determine the creditworthiness of a business. They assess the company's ability to repay loans by analyzing its solvency and financial stability. Similarly, creditors, who supply goods or services on credit, use this information to decide the terms of credit and evaluate the risk of non-payment.
- **Employees:** Employees are interested in the financial well-being of the company to ensure job security and the potential for wage increases or bonuses. They use accounting information to gauge the company's ability to sustain operations and invest in employee benefits and growth opportunities.
- **Tax Authorities:** Tax authorities review financial statements to calculate tax liabilities accurately. They ensure that the business complies with tax laws and

regulations by analyzing its financial records, which helps in the fair assessment and collection of taxes.

- **Regulatory Agencies:** Regulatory agencies use accounting information to ensure that businesses comply with the legal and regulatory framework. They monitor financial disclosures to protect stakeholders' interests, maintain transparency, and ensure fair market practices.
- **Potential Investors:** Potential investors analyze accounting information to evaluate the attractiveness and viability of investing in a business. They review financial performance and growth prospects to determine the risk and potential returns on their investment, helping them make informed decisions about partnership or equity investment.

Objectives of accounting

Accounting has evolved to meet the growing complexity of modern businesses. Below are the traditional objectives complemented by modern objectives that emphasize strategic, technological, and analytical aspects:

Traditional Objectives

1. **Maintaining Systematic Records:** Accounting ensures the organized recording of all financial transactions, such as purchases, sales, cash inflows, and outflows. These systematic records serve as a permanent reference for analysis, audits, and legal compliance.
2. **Determining Net Profit or Loss:** By accurately recording income and expenses, accounting enables businesses to prepare the Profit and Loss Account, which evaluates financial performance over a specific period.

3. **Assessing Financial Position:** Through the preparation of a Balance Sheet, accounting provides insights into a business's assets, liabilities, and equity, helping stakeholders evaluate solvency and financial stability.
4. **Providing Information to Stakeholders:** Accounting generates essential financial information for various stakeholders, including investors, creditors, tax authorities, and regulatory agencies, to facilitate informed decision-making.

Modern Objectives

1. **Facilitating Decision-Making:** Modern accounting extends beyond recording transactions to provide actionable insights. Analytical tools and techniques allow businesses to evaluate performance, assess risks, and make strategic decisions.
2. **Supporting Financial Planning and Budgeting:** Accounting enables businesses to prepare budgets and forecast future financial activities, aligning resources with organizational goals and ensuring operational efficiency.
3. **Ensuring Compliance and Transparency:** In an era of increased regulatory scrutiny, accounting ensures adherence to financial laws, international accounting standards, and corporate governance requirements, promoting transparency and trust among stakeholders.
4. **Integrating Technology and Automation:** With advancements like cloud computing and AI-driven analytics, modern accounting systems automate routine processes, providing real-time financial data for faster and more accurate decision-making.

5. **Enhancing Sustainability and ESG Reporting:** Modern businesses incorporate environmental, social, and governance (ESG) factors into their accounting practices. Accounting now includes tracking and reporting on sustainability initiatives and social impact.
6. **Improving Internal Controls and Fraud Detection:** Accounting systems incorporate robust internal controls and forensic tools to identify discrepancies and prevent fraud, ensuring ethical financial management.
7. **Supporting Global Operations:** With globalization, accounting facilitates cross-border operations by managing multi-currency transactions, tax implications, and compliance with international financial regulations.
8. **Enabling Data-Driven Insights:** Leveraging big data and advanced analytics, accounting provides predictive insights that support strategic planning, risk assessment, and competitive analysis.

These modern objectives underscore accounting's transformation from a traditional bookkeeping function to a strategic tool that drives innovation, ensures sustainability, and fosters global competitiveness in the contemporary business landscape.

History and Evolution of Accounting

Accounting has a rich and extensive history, tracing its roots back to ancient civilizations. Its origins can be linked to Babylonia and Egypt around 4000 B.C., where records of wages and taxes were maintained on clay tablets. In Egypt, treasuries used a rudimentary form of accounting to manage gold and other valuables. Treasury officials reported daily to their superiors, known as Wazirs (prime ministers), and sent consolidated monthly reports to the kings, ensuring effective oversight.

Babylonia, a hub of commerce, employed accounting to identify business inefficiencies and fraud. In Greece, accounting played a key role in distributing revenues among treasuries and tracking government financial transactions, including total receipts and expenditures. The Romans (700 B.C.–400 A.D.) refined these practices, recording daily transactions in daybooks and transferring them to ledgers monthly. By 2000 B.C., China had developed advanced governmental accounting systems, showcasing early sophistication in managing state resources.

In ancient India, the seminal text *Arthashastra* by Kautilya, written over 2300 years ago during the reign of Chandragupta Maurya, outlined detailed accounting practices. This included methods for maintaining systematic records of financial activities to support governance and economic management.

The foundations of modern accounting were laid by **Luca Pacioli**, often referred to as the "Father of Accounting," in his 1494 publication *Summa de Arithmetica*. Pacioli formalized the double-entry bookkeeping system, which ensures every financial transaction has corresponding debit and credit entries. Although he did not claim to invent the system, his work popularized its use. Pacioli also stressed the importance of ethical practices, accuracy in record-keeping, and ensuring profitability in business operations.

Contemporary Relevance

In addition to its historical significance, modern accounting has evolved with technological advancements. Today, accounting integrates digital tools for real-time financial reporting, compliance, and decision-making. This progression reflects its enduring role as a critical tool for economic management and accountability across societies.

Branches of Accounting

Accounting has evolved over centuries, adapting to economic, social, and technological changes. This evolution has led to the development of various specialized branches, each serving distinct purposes:

1. **Financial Accounting:** Financial accounting involves recording, summarizing, and reporting financial transactions of a business. It focuses on the preparation of financial statements such as the balance sheet, income statement, and cash flow statement, which provide an overview of the financial performance and position of the business to external stakeholders, including investors, creditors, and regulators.

2. **Management Accounting:** Management accounting provides internal management with detailed financial and non-financial information to aid in decision-making, planning, and performance evaluation. It includes budgeting, forecasting, variance analysis, and cost-benefit analysis, enabling managers to make informed strategic decisions and improve operational efficiency.

3. **Cost Accounting:** Cost accounting focuses on analyzing the costs associated with producing goods or services. It helps businesses understand the cost structure, identify areas for cost control, and determine product pricing. This branch involves methods like standard costing, activity-based costing, and job costing to allocate costs accurately and enhance profitability.

4. **Tax Accounting:** Tax accounting deals with the preparation and filing of tax returns, ensuring compliance

with tax regulations. It involves planning to minimize tax liabilities and keeping up-to-date with changes in tax laws. This branch is crucial for businesses to manage their tax obligations effectively and avoid penalties.

5. **Auditing:** Auditing involves the independent examination of financial statements to ensure they are accurate and comply with accounting standards and regulations. It can be internal or external, with internal audits focusing on improving internal controls and processes, while external audits provide assurance to stakeholders about the reliability of financial reports.

6. **Forensic Accounting:** Forensic accounting specializes in investigating financial discrepancies, fraud, and embezzlement. It combines accounting and investigative skills to analyze financial data and provide evidence for legal proceedings. Forensic accountants play a crucial role in litigation support, fraud detection, and dispute resolution.

7. **Fiduciary Accounting:** Fiduciary accounting involves managing and reporting financial activities related to estates, trusts, and receiverships. It ensures that fiduciaries, such as trustees or executors, fulfill their legal obligations to manage assets responsibly and report to beneficiaries and courts as required.

8. **Governmental Accounting:** Governmental accounting focuses on the financial management and reporting of government entities. It ensures transparency, accountability, and compliance with governmental accounting standards. This branch involves preparing

budgets, financial statements, and audits to manage public funds effectively and ensure responsible governance.

Advantages of Accounting

Accounting serves several critical functions that are essential for the effective management and operation of a business. These functions include:

- **Recording Financial Transactions:** Accounting systematically records all financial transactions, ensuring a comprehensive and accurate financial history is maintained. This eliminates the need to rely on memory and provides a reliable reference for any required information.
- **Providing Control Over Assets:** By maintaining detailed records of assets such as cash, inventory, and receivables, accounting enables management to monitor and utilize these assets effectively, ensuring optimal use and safeguarding against misuse.
- **Facilitating Preparation of Financial Statements:** Accurate accounting records are the foundation for preparing essential financial statements, including the Profit and Loss Account and the Balance Sheet. These statements provide insights into the company's performance and financial position.
- **Meeting Information Requirements:** Various stakeholders, such as owners, lenders, and creditors, rely on accounting information to make informed decisions. Regular financial reporting ensures that these parties have access to the necessary data to assess the company's health and make strategic choices.

- **Facilitating Comparative Analysis:** Accounting allows for the comparison of current performance with past results and with other similar organizations. This comparative analysis helps management identify trends, strengths, and areas for improvement.
- **Assisting Management in Decision-Making:** Accounting information provides a basis for strategic planning and control. It aids management in making informed decisions regarding budgeting, investments, and operational adjustments.
- **Preventing and Detecting Fraud:** Regular reconciliation and verification of accounting records make it difficult to conceal fraudulent activities. Internal controls and periodic audits further enhance the detection and prevention of fraud and theft.
- **Ensuring Compliance with Tax Regulations:** Properly maintained accounting records facilitate accurate calculation and timely payment of taxes, ensuring compliance with various tax laws and avoiding legal penalties.
- **Determining Business Valuation:** In the event of a sale or merger, accounting records provide a clear picture of the company's financial status, aiding in the accurate valuation of the business.
- **Serving as Legal Evidence:** Systematic and well-maintained accounting records are often accepted as credible evidence in legal disputes, providing a factual basis for resolving conflicts.

These functions collectively ensure that a business operates efficiently, remains compliant with legal requirements, and provides transparency to stakeholders.

Limitations of Accounting

Accounting information serves as a critical tool for various stakeholders to assess a business's profitability and financial health. However, it is essential to recognize the inherent limitations of accounting practices:

1. **Exclusion of Non-Financial Transactions:** Traditional accounting systems primarily focus on financial transactions, omitting non-financial elements such as the quality of human resources, licenses held, locational advantages, and business relationships. This exclusion can result in an incomplete portrayal of a company's true value and potential.
2. **Historical Cost Basis:** Accounting often relies on historical cost for asset and liability valuation, which may not reflect current market values. For instance, assets like land and buildings might have appreciated significantly since their purchase, yet their book value remains based on the original cost, leading to potential undervaluation.
3. **Influence of Accounting Conventions and Personal Judgments:** Financial statements are shaped by established accounting conventions and the subjective judgments of accountants. Estimates are frequently employed to determine values for items such as doubtful debts, inventory obsolescence, and asset depreciation. These estimations are inherently influenced by personal judgment, which can affect the accuracy and reliability of the reported information.
4. **Insufficient Data for Informed Decision-Making:** While financial statements provide an overview of a business's profitability, they often lack detailed information necessary

for comprehensive analysis and strategic decision-making. Specifically, they may not offer insights into the costs and profitability associated with individual activities or segments within the organization.

In addition to these traditional limitations, the increasing use of big data presents new challenges and opportunities for accounting. The integration of vast datasets necessitates advanced technologies, such as artificial intelligence and machine learning, to enhance data analysis and anomaly detection. However, this also raises concerns regarding data privacy and security, emphasizing the need for continuous learning and adaptation within the profession.

Recognizing these limitations and emerging challenges is crucial for stakeholders who rely on accounting information. It highlights the importance of supplementing financial data with qualitative insights and staying informed about ongoing developments in accounting practices to make well-rounded and effective business decisions.

Distinction between Book-keeping and Accounting

Accounting is a broad subject. It calls for a greater understanding of records obtained from book-keeping and an ability to analyse and interpret the information provided by booking keeping records. Book-keeping, also called as **Steward Accounting**, is a small part of the field of accounting just as arithmetic is a small part of the broad discipline of mathematics. Book-keeping is the recording phase whereas accounting is the summarizing phase of an accounting system and so it is often said that the process of **accounting begins where the book-keeping process ends**. The distinction between book-keeping and accounting may be summarized as follows:

	Book-keeping	Accounting
1.	It is the reporting phase of an accounting system.	It is the summarizing phase of an accounting system.
2.	It is the basis of accounting.	It is the basis for financial data.
3.	Persons responsible for book-keeping are called book-keepers.	Person responsible for accounting are called accountants.
4.	It does not require any special skill or knowledge.	It requires special skill or knowledge.
5.	Personal judgment of the book-keeper is not required.	Personal judgment of the account is essential. For example, at the time of making provision for bad debts, personal judgement is necessary.
7.	It does not give the complete picture of the financial condition of the business unit.	It gives the complete picture of the financial condition of the business unit.
8.	It does not help in complying with legal formalities.	Legal formalities can be complied with the help of accounting.
9.	It does not provide any information for taking managerial decisions.	It provided information for taking managerial decisions.
10.	It has no branch.	It has several branches, e.g., financial accounting, cost accounting, management accounting, etc.

Accounting process

The Accounting Process is a systematic sequence of activities undertaken to identify, record, classify, summarize, and interpret financial transactions. It provides a structured framework for preparing financial statements and analyzing business performance. The process involves four primary stages, as detailed below:

1. Recording the Transactions

The accounting process begins with identifying and recording all financial transactions in the **book of original entry**, commonly referred to as the **Journal**. Transactions are documented chronologically (in date order) using supporting evidence such as cash memos, receipts, invoices, and vouchers. This stage ensures that every financial event is captured accurately, serving as the foundation for subsequent steps.

2. Classifying the Transactions

The second stage involves classifying transactions of a similar nature by posting them into a ledger, a book containing individual accounts. This step is executed by transferring data from the journal into their respective accounts within the **Ledger**. For example:

- All cash-related transactions are grouped under the **Cash Account**.
- Transactions involving specific customers or suppliers are recorded in individual accounts for those parties.

Periodic balancing of these accounts allows businesses to determine the overall impact of transactions during a specific period. By organizing and grouping related data, classification facilitates better understanding and analysis of financial activities.

3. Summarizing the Transactions

Once transactions have been classified and posted to the ledger, the next step is to summarize the financial data. This stage aims to provide a consolidated view of the business's financial performance and position over a period. It involves the following steps:

- **Preparation of the Trial Balance:** Before summarizing, a trial balance is prepared to check the arithmetic accuracy of the records. If the trial balance tallies (i.e., total debits equal total credits), it confirms that transactions have been accurately recorded and posted.
- **Preparation of Final Accounts:** Using the trial balance and other relevant data, the Final Accounts are prepared. Final accounts consist of:
  1. **Trading and Profit & Loss Account:** This statement shows the operational performance of the business, reflecting the profit earned or loss incurred during the accounting period.
  2. **Balance Sheet:** The balance sheet is a position statement that lists the business's assets, liabilities, and equity as of the year-end date, providing a snapshot of financial health.

The summarization process ensures that stakeholders can understand the net results of business activities and the financial standing of the organization.

4. Interpreting the Results

The final stage of the accounting process is analyzing and interpreting the results shown in the financial statements. This step involves calculating key financial ratios and metrics to assess:

- **Liquidity:** The ability of the business to meet short-term obligations.
- **Solvency:** The capacity to meet long-term debts and sustain operations.

- **Profitability:** The efficiency and success of the business in generating profits.

Interpretation is critical for stakeholders, such as management, investors, creditors, and bankers, as it provides insights into the organization's performance, financial health, and future prospects.

Continuous Process and Transition

At the end of the accounting period, balances from various accounts in the balance sheet are carried forward to the new books of account for the subsequent year. Once the financial statements are finalized and interpreted, the process restarts for the next financial year with the recording of new transactions.

This systematic approach ensures that financial records are accurate, transparent, and useful for decision-making, enabling businesses to fulfill statutory requirements and maintain accountability to stakeholders.

Basic Terms in Accounting

Certain terms are so basic in accounting that it forms its lexicon.

Entity - Entity means a reality that has a definite individual existence. Business entity means a specifically identifiable business enterprise **separate from the owner**. An accounting system is always devised for a specific business entity (also called accounting entity).

Transaction - An event involving valuable **give and take** between two or more entities. It can be a purchase of goods, receipt of money, payment to a creditor, incurring expenses, etc. It can be a **cash transaction** or a **credit transaction**.

Assets - Assets are economic resources of an enterprise used in its operation resulting in monetary returns. Assets can be broadly classified into two types: **current assets** and **non-current or fixed assets**.

Liabilities - Liabilities are obligations or debts that an enterprise has to pay at some time in the future. They represent **creditors' claims on the firm's assets**.

Capital - Amount invested by the owner in the firm is known as capital. It may be brought in the form of cash or assets by the owner. For a business entity, capital is an obligation, owner's claim on the assets of business.

Revenues - Revenue is the amount earned by the business entity during a period. The amounts earned by selling its products or providing its services to customers is called **sales revenue or sales**. Sales may be **cash sales** or **credit sale**. Other items of revenue common to many businesses are: commission, interest, dividends, royalties, rent received, etc. Revenue is also called **income**.

Expenses - Generally, expenses are measured by the cost of assets consumed or services used during an accounting period. The usual items of expenses are: depreciation, rent, wages, salaries, interest, cost of heater, light and water, telephone, etc.

Expenditure - Spending money or incurring a liability for some benefit, service or property received by a business entity in the process of earning revenue are known as expenditure. If the benefit of expenditure is exhausted within a year, it is treated as an expense (also called **revenue expenditure**). On the other hand, the benefit of an expenditure lasts for more than a year, it is treated as an asset (also called **capital expenditure**). Some expenditures may not result in assets but give benefits for more than one accounting periods, are called **deferred revenue expenditure**.

Profit - The excess of revenues of a period over its related expenses during an accounting year is profit. Profit increases the investment of the owners. Profit may be distinguished from **gain** that arises from events or transactions which are incidental to business such as sale of fixed assets, winning a court case, appreciation in the value of an asset.

Loss - The excess of expenses of a period over its related revenues its termed as loss. It decreases in owner’s equity. It also refers to money or money’s worth lost (or cost incurred) without receiving any benefit in return, e.g., cash or goods lost by theft or a fire accident, etc. It also includes loss on sale of fixed assets.

Discount - Discount is the deduction in the price of the goods sold. It is offered in two ways. Offering deduction of agreed percentage of list price at the time selling goods is one way of giving discount, called as **trade discount**. It is generally offered by manufactures to whole sellers and by whole sellers to retailers. After selling the goods on credit basis the debtors may be given certain deduction in amount due in case if they pay the amount within the stipulated period or earlier. This deduction is given at the time of payment on the amount payable. Hence, it is called as **cash discount**. Cash discount acts as an incentive that encourages prompt payment by the debtors.

Voucher - The documentary evidence in support of a transaction is known as voucher.

Goods - It refers to the products in which the business unit is dealing, i.e. in terms of which it is buying and selling or producing and selling. The items that are purchased for use in the business are not called goods, rathe termed as assets.

Drawings - Withdrawal of money and/or goods by the owner from the business for personal use is known as drawings. Drawings reduces the investment of the owners.

Purchases - Purchases are total amount of goods procured by a business on credit and on cash, for use or sale. In a trading concern, purchases are made of merchandise for resale with or without processing. In a manufacturing concern, raw materials are purchased, processed further into finished goods and then sold. Purchases may be **cash purchases** or **credit purchases**.

Stock - Stock (inventory) is a measure of on-hand goods, spares and other items to be used by the business entity for sale or processing. It is called Stock in hand. In a trading concern, the stock on hand is the amount of goods which are lying unsold as at the end of an accounting period is called **closing stock** (ending inventory). In a manufacturing company, closing stock comprises raw materials, semi-finished goods and finished goods on hand on the closing date. Similarly, **opening stock** (beginning inventory) is the amount of stock at the beginning of the accounting period.

Debtors - Debtors are persons and/or other entities who owe to an enterprise an amount for buying goods and services on credit. The total amount standing against such persons and/or entities on the closing date, is shown in the balance sheet as sundry debtors on the asset side.

Creditors - Creditors are persons and/or other entities who have to be paid by an enterprise an amount for providing the enterprise goods and services on credit. The total amount standing to the favour of such persons and/or entities on the closing date, is shown in the Balance Sheet as sundry creditors on the liabilities side.