

MEANING OF KEY TERMS USED IN THE CHAPTER

1. Cash Basis of Accounting	It is a system of accounting according to which transactions are recorded in the books of account when cash is transacted whether received or paid.
2. Accrual Basis of Accounting	It is a system of accounting according to which transactions are recorded in the books of account when transaction is entered into irrespective of cash having been received or not.
3. Outstanding Expenses	They are those expenses which have been incurred during the accounting period but have not yet been paid during the year. In the Balance Sheet, they are shown as liability.
4. Prepaid Expenses	They are those expenses which have been paid in advance. In the Balance Sheet, they are shown as an asset.
5. Accrued Income	It is an income which has been earned during the accounting period but has not yet become due for payment and, therefore, has not been received. In the Balance Sheet, it is shown as an asset.
6. Income Received in Advance	It is an income which has been received before it has been earned, <i>i.e.</i> , goods have been sold or services have been rendered. In the Balance Sheet, it is shown as a liability.

Terms at serial numbers 3, 4, 5 and 6 will appear when accrual basis of accounting is followed.

CHAPTER SUMMARY

- **Bases of Accounting:** For recording financial transactions, there can be two broad approaches to accounting.

These are:

1. Cash Basis and
2. Accrual or Mercantile Basis.

- **Cash Basis of Accounting:** A system in which accounting entries are made only when cash is transacted whether received or paid.
- **Accrual or Mercantile Basis of Accounting:** A system in which income is recorded when it is earned, whether received or not. Similarly, expense is recorded when incurred, whether paid or not.

This basis is also known as **Mercantile Basis of Accounting**. Under the Companies Act, 2013, all companies are required to maintain the books of account according to accrual basis of accounting.