

Acc 2N3 - System and bases of accounting

SYNOPSIS

System of accounting

- Double entry system
- Single entry system

Basis of accounting

- Cash basis
- Accrual basis

Systems of accounting

The systems of recording transactions in the book of accounts are generally classified into two types viz. Double entry system and Single entry system.

Double entry system is based on the principle of “Dual Aspect” which states that every transaction has two effects, viz. receiving of a benefit and giving of a benefit. Each transaction, therefore, involves two or more accounts and is recorded at different places in the ledger. The basic principle followed is that every debit must have a corresponding credit. Thus, one account is debited and the other is credited. Double entry system is a complete system as both the aspects of a transaction are recorded in the book of accounts. The system is accurate and more reliable as the possibilities of frauds and mis-appropriations are minimised. The arithmetic inaccuracies in records can mostly be checked by preparing the trial balance. The system of double entry can be implemented by big as well as small organisations.

Single entry system is not a complete system of maintaining records of financial transactions. It does not record two-fold effect of each and every transaction. Instead of maintaining all

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the accounts, only personal accounts and cash book are maintained under this system. In fact, this is not a system but a lack of system as no uniformity is maintained in the recording of transactions. For some transactions, only one aspect is recorded, for others, both the aspects are recorded. The accounts maintained under this system are incomplete and unsystematic and therefore, not reliable. The system is, however, followed by small business firms as it is very simple and flexible.

### **Basis of Accounting**

From the point of view the timing of recognition of revenue and costs, there can be two broad approaches to accounting. These are: (1) Cash basis; and (2) Accrual basis.

**Cash basis:** Under the cash basis, entries in the book of accounts are made when cash is received or paid and not when the receipt or payment becomes due. Let us say, for example, if office rent for the month of December 2014, is paid in January 2015, it would be recorded in the book of account only in January 2015. Similarly, sale of goods on credit in the month of January 2015 would not be recorded in January but say in April, when the payment for the same is received. Thus, this system is incompatible with the matching principle, which states that the revenue of a period is matched with the cost of the same period. Though simple, this method is inappropriate for most organisations as profit is calculated as a difference between the receipts and disbursement of money for the given period rather than on happening of the transactions.

**Accrual basis:** Under the accrual basis, however, revenues and costs are recognised in the period in which they occur rather when they are paid. A distinction is made between the receipt of cash and the right to receive cash and payment of cash and legal

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obligation to pay cash. Thus, under this system, the monetary effect of a transaction is taken into account in the period in which they are earned rather than in the period in which cash is actually received or paid by the enterprise. This is a more appropriate basis for the calculation of profits as expenses are matched against revenue earned in relation thereto. For example, raw material consumed are matched against the cost of goods sold.