

ADVANCED ACCOUNTING

3rd SEMESTER

TOPIC:

RECORDING OF TRANSACTIONS – ASCERTAINMENT OF PROFIT

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Meaning of Single Entry System:

Under this system, a Cash Book is prepared which shows the receipts and payments of cash transactions and no other ledger is maintained except a rough book for recording transactions relating to personal accounts. It is actually called 'Pure Single Entry'.

Under this method, real accounts and nominal accounts are not recognised.

In short, these transactions are only recorded in Cash Book without, however, applying the principles of double entry. That is why it is said: 'The system which does not totally follow the principles of Double Entry System is called Single Entry System'.

For recording transactions relating to personal accounts, however, double entry system is followed, say, when cash is received from a customer—it is recorded in Cash Book first and, thereafter, in the personal account of the customer concerned, i.e., recorded in two places—like double entry basis.

Again, no entry is recorded in the books of accounts for any internal transactions, like depreciation on assets. Therefore, it may be said that Single Entry System is nothing but an admixture of Single Entry, Double Entry, and no entry.

According to R. N. Carter, Single Entry cannot be termed as a system, as it is not based on any scientific system like Double Entry System

For this purpose, Single Entry is nowadays known as Preparation of accounts from incomplete records. Practically, this system is followed by those firms whose transactions are limited and, at the same time, who maintain only the essential records. There is no hard and fast rule for maintaining records under this system, i.e., it depends on the circumstances and the necessity of the firm.

Salient Features of Single Entry System:

The salient features of Single Entry System are:

- (i) This system is followed by a sole proprietorship firm or a partnership firm. The companies cannot follow this system.
- (ii) Under this system, only one Cash Book is maintained which mixes up both the private and business transactions.
- (iii) Usually personal accounts are recorded only, i.e., Real and Nominal accounts are ignored.

(iv) Lack of uniformity is noticed if accounts are kept under Single Entry basis.

(v) Profit or loss, under this system, can be ascertained but not the financial position as a whole.

(vi) Arithmetical accuracy of the account is not possible since Trial Balance cannot be prepared.

(vii) Practically, this system is the admixture of Single Entry, Double Entry and no entry.

Advantages of Single Entry System:

1. It is a simple method of recording business transactions because an elaborate accounting procedure is not involved in this system.
2. As rules of double entry system are not followed under the single entry system, knowledge of the principles of double entry system of accounting is not necessary for recording business transaction. Hence any person can maintain books of accounts under this system.

3. This system is less costly when compared to double entry system because only a few books are to be maintained and a few staff members are appointed for maintaining the books of accounts.

4. There is economy of time and labors (i.e. a lot of time and labor is saved) under this system because of limited number of transactions of a small business concern adopting this system and lesser number of books of accounts required to be maintained.

5. Single entry is flexible in the sense that the recording procedure (i.e. the procedure of recording transactions in the books of accounts) can be adjusted according to the information needs of the particular business concern.

6. As single entry system is simple and less costly, it is suitable for small business concerns which have less number of transactions, mostly cash transactions.

Disadvantages of Single Entry System:

1. This system is an incomplete system of accounting because the two aspects of each and every transaction are not recorded in the books of accounts.
2. As the two aspects are not recorded, it is not possible to prepare a trial balance and verify the arithmetical accuracy of the books of accounts under this system.
3. As the arithmetical accuracy of the books of accounts cannot be checked by preparing a trial balance, this system gives much scope for carelessness, errors, misappropriation and fraud.

4. As the accounts of purchases, expense, and incomes are not kept under this system, it is not possible to prepare a trading, and profit and loss account to find out the correct profits and losses. The profits or losses ascertained under this system only by comparing the capital at the end of the trading period (i.e. closing capital) with the capital at the beginning of the trading period (i.e. opening capital), are inaccurate and unreliable. The profits are just estimated profits and not real profits.

5. This system does not provide any useful information about the sources of profit or losses (i.e. about the various items of expenses and incomes responsible for profits and losses.)

6. As no real accounts (other than cash account) and personal accounts (other than personal accounts of trade debtors or trade creditors) are maintained under this system, it is not possible to prepare a balance sheet for ascertaining the correct financial position of the business.

The financial position of the business ascertained under this system by preparing a statement of affairs, does not reveal the correct financial position of the business because the values of various assets and liabilities shown in the statement of affairs are not proved by accounts but are calculated mainly by estimate and memory.

7. Full information about the business is not available under this system because of incomplete records. So, the value of a business cannot be correctly determined.

8. Comparison of trading results (i.e. profits or losses) and financial position from year to year is not possible under system because of absence of comparable figures of previous year.

9. This system does not satisfy legal requirements regarding the maintenance of proper books of accounts.

10. This system is not accepted in the court of law as evidence.

11. As it is an incomplete system, the actual income of the business concern may be concealed, and tax may be reduced under this system. That means this system encourages tax evasion by the businessmen.

12. The accounts prepared under the single entry system do not inspire confidence in outsiders owing to the lack of any test to check their arithmetical accuracy. So the accounts prepared under this system are less reliable.

13. Inter firm comparison (i.e. comparison of the results of two or more business firms) is not possible under the single entry system, because of the variations in accounting procedures adopted by various firms.

Double Entry System

This is the more traditional and conventional system for recording transactions in financial accounting. This is a scientific method which has some rules and principles which must be followed. The basic essence of the double entry system is that every transaction will affect two accounts. This is known as the debit and credit rule – every credit entry, there must be a corresponding debit entry.

The double entry system is the one widely used and recognized in the accounting world. Some salient features of this system are,

- ✓ All three types of accounts are maintained in this system – real, nominal and personal
- ✓ The arithmetic accuracy of the financial records are verified by preparing the trial balance
- ✓ The system does not have many modifications.
- ✓ It allows for the preparation of the balance sheet which will reflect the financial position of the organization
- ✓ Easy to detect frauds and errors in this double entry system

Basis of Accounting

This deals with the timing of the revenue recognition, i.e. when should the revenue be recognized in the books of accounts. There are two approaches to this dilemma – cash basis of accounting and accrual basis of accounting. Let us take a brief look at both.

1. Cash Basis of Accounting

This is the simpler, uncomplicated approach. Under the cash system of accounting an income will only be recorded when it comes in.

So an income will be earned when it is received in cash by the organization. And similarly, the expenses will also be recorded only when they are actually made.

So take for example the organization pays the salary of its employees for the month of June on the 3rd of July. This salary expense will thus be recorded in July, although the expense is for the period of June. Similarly, say the organization made a credit sale on 5th August. They received the payment on 11th October, so this sale will be recorded on this date.

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2. Accrual Basis of Accounting

Accrual basis is the more logical and scientific approach to accounting. This is the method most organizations chose to adopt, as it gives a more fair representation of the financial position of the company

In the accrual system, the revenues and expenses are recognized in the time period in which they occur, not when the money actually comes in.

And the expense is recorded when it becomes due, irrespective of whether it has been paid.

So in accrual system, all incomes and expenses – cash items and non-cash items (like prepaid/outstanding expenses and accrued/advance income) will be taken into account. And the final accounts will be a true representation of the organization's financial position. So the income will be recorded if it is earned irrespective of whether the payment has come in or not.

Distinction between Double and Single Entry

Point of Distinction	Double Entry	Single Entry
Basic principle	Both the aspects of transactions i.e. Dr. and Cr. will be recorded immediately.	Both the aspects and even one aspect may not be recorded.
Nature of recording	Scientific, methodical, systematic and complete.	Incomplete and haphazard.
Nature of a/c covered	Real, personal and nominal.	Generally personal, at times real and rarely nominal.
Check of accuracy	Can be done, as a trial balance can be prepared.	Cannot be done as the trial balance cannot be prepared.
Final accounts	Can be prepared systematically and profit and financial position can be accurately known by preparing trading, P&L, and Balance Sheet.	No such a/c can be prepared and profit and loss and financial position cannot be known.
Suitability	Suitable for all kinds of businesses.	Suitable only to small sized businesses.
Cost of maintenance	Quite expensive as it involves procedures, books of a/c etc.	Comparatively less expensive.
Capital	The balance of capital can be accurately calculated by capital a/c.	Capital calculated is not as accurate as it is at the best balancing figure.
Degree of reliability	Highly reliable as it is based on scientific principles. The books maintained under this are accepted as evidence by the court of law and by the government authorities.	This system is not reliable as double entry system because it is unscientific and incomplete.
Ease of learning	It is an elaborate system of principle rules to maintain the books of a/c.	This system involves very few procedures and can be learnt easily.

Preparing Statement of Affairs:

Under this method, statement of asset and liabilities as at the beginning and at the end of the relevant accounting period are prepared to ascertain the amount of change in the capital during the period. Such a statement is known as statement of affairs, shows assets on one side and the liabilities on the other just as in case of a balance sheet.

The difference between the totals of the two sides (balancing figure) is the capital below proforma. Though statement of affairs resembles balance sheet, it is not called a balance sheet because the data is not wholly based on ledger balances. The amount of items like fixed assets, outstanding expenses, bank balances, etc. are ascertained from the relevant documents and physical count.

Proforma of Statement of Affairs

Liabilities	Amount	Assets	Amount
Creditors	xxx	Building	xxx
Bills Payable	xxx	Plant and Machinery	xxx
Outstanding Salaries	xxx	Furniture	xxx
Capital (Balancing Figure)	xxx	Investments	xxx
		Stock	xxx
		Debtors	xxx
		Cash in hand	xxx
		Bills receivables	xxx
Total	xxxx	Total	xxxx

Ascertainment of Profit or Loss:

Every business firm wishes to ascertain the results of its operations to assess its efficiency and success and failures. This gives rise to the need for preparing the

financial statements to disclose:

(a) the profit made or loss sustained by the firm during a given period; and

(b) the amount of assets and liabilities as at the closing date of the accounting period.

Therefore, the problem faced in this situation is how to use the available

information in the incomplete records to ascertain the profit or loss for the particular accounting year and to determine the financial position of a entity as at the end of the year. This can be done in two ways :

1. Preparing the Statement of Affairs as at the beginning and as at the end of the accounting period, called statement of affairs or net worth method.

2. Preparing Trading and Profit and Loss Account and the Balance Sheet by putting the accounting records in proper order, called conversion method.

Statement of Profit or Loss for the year ended

Particulars	Amount
Capital as at the end of year (computed from statement of affairs as at the end of year)
<i>Add Drawings during the year</i> (.....)
<i>Less Additional capital introduced during the year</i>
Adjusted capital at the end of year	
<i>Less Capital as at the beginning of year (computed from statement of affairs as at the beginning of year)</i>	(.....)
Profit or Loss made during the year

Proforma of Statement of Profit or Loss

Particulars	Rs.	Rs.
Closing Capital	xxx	xxx
Add: Drawings (made during the year)	xxx	xxx
Less: Additional Capital Introduced	xxx	xxx
Adjusted capital	xxx	xxx
Less: Opening Capital	xxx	xxx
Gross Profit	xxx	xxx
Less: Expenses	xxx	xxx
Outstanding expenses	xxx	xxx
Income received in advance	xxx	xxx
Bad debts	xxx	xxx
Provision for Bad debts	xxx	
Provision for discount on debtors	xxx	
Depreciation on assets	xxx	
Reserve for doubtful debts		
Interest on loan		
Add: Incomes		
Appreciation in value of assets		
Interest on drawings		
Reserve for discount on creditors		
Prepaid expenses		
Outstanding incomes		
Net Profit	xxx	xxx



THANK YOU