

Quadrant II – Notes

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Module Name : Introduction; Meaning of Three Systems of Accounting and Books of Accounts maintained by the Professionals

Module No : 01

Notes

ACCOUNTING FOR PROFESSIONALS

Professionals like Doctors, Lawyers, Accountants, etc. maintain and prepare their accounts on a cash basis because the number of transactions are very few. But if there are large number of credit transactions, accrual system may also be adopted by them. If cash basis of accounting is followed, it does not mean that outstanding expenses or incomes, depreciation, provisions, etc. are not adjusted. In most of the cases, professionals will record all incomes on cash basis, whereas expenses are recorded on accrual or mixed system.

SYSTEMS OF ACCOUNTING

1. Cash System

In the Cash system of accounting, entries are made only when cash is received or paid, no entry being made when a payment or receipt is merely due. It recognizes only those transactions which involve actual cash receipts and disbursements, prepayments and accruals are not recorded.

2. Accrual/Mercantile System

The Mercantile system recognizes revenue and expenses as they are earned or incurred. A record is made on the basis of amounts having become due for payment or receipt.

Revenue from sale of goods is recognized when goods are sold out. Cash may be received or not. Cost of goods purchased is recognized when goods are purchased. Payment may be made later on.

For instance at the end of March, rent of Rs. 5,000 becomes due but payment is made on 15th April. If accounts are closed on 31st March, no entry will be made on this date if accounts are kept on cash basis; it will be made on 15th April. However, if accounts are kept on the mercantile system, two entries will be made;

- a. On 31st March, showing the expense by way of rent having been incurred and a liability in that regard having arisen; and
- b. On 15th April, showing that the liability has been settled.

The mercantile system is better since it takes into account the amounts that become due. This is necessary for preparing financial statements on proper lines.

3. Hybrid/Mixed System

It is a combination of the cash and accrual systems. Under this, expenses are recorded under the Accrual System and incomes are recorded under the Cash System.

BOOKS OF ACCOUNTS MAINTAINED BY PROFESSIONALS

1. Cash Book

The cash book is meant to record all cash transactions. It is divided into two sides, the left hand side, for receipts of cash and the right hand side, for payments. Since in a modern business, transactions through bank are even more numerous than strictly cash transactions, each side has two columns – one to record cash transactions and the other to record bank transactions.

2. Memorandum Book

In the case of professionals, credit transactions are very few. Such transactions are noted in a memorandum book so that they are not forgotten. The transactions are scored off from the Memorandum Book and entered in the cash book when they are actually received or paid for.

3. Stock Register

A stock register is kept for keeping a record of all articles purchased for use for the profession such as stationery, calculators, books, surgical instruments, furniture, computers, printers, etc. For example, medicines in the case of doctors. When any article is consumed or destroyed, a note to that effect should be made in the stock register. This will help to ascertain the stock on any particular day and compare with the physical stock.

4. Receipts & Expenditure Account

Instead of Income and Expenditure Account, professional prepare Receipt and Expenditure Account. It is similar to the Income and Expenditure Account with the exception that the Income and Expenditure Account shows both income received and income outstanding for the period. Whereas, in case of professional Receipt and Expenditure Account only the actual income received is shown. Outstanding income is ignored because they maintain accounts on cash basis. Outstanding income is also ignored because professionals do not file suits to recover their dues and hence there is no guarantee of receiving such income in

the future. Outstanding income is considered as income only when it is actually received.

However, expenditure side shows expenses paid as well as outstanding.

This means expenditure is considered on accrual basis whereas income is considered on cash basis. Therefore the account is known as Receipt and Expenditure Account which means the professionals actually follow the Hybrid System.

5. Balance Sheet

A Balance Sheet is a list of assets and claims of a business at some specific point of time. It shows the financial position of a business by detailing the sources of funds and the utilization of these funds. A Balance Sheet shows the assets and liabilities.

FORMAT

Receipt and Expenditure Account

Expenditures	Amount	Receipts	Amount
To opening WIP	xx	By fees received	xxx
To salaries	xx	By interest	xx
To taxes and insurance	xx	By sundry/miscellaneous receipts	xx
To journals and books	xx	By closing WIP	xx
To rent	xx		
To lighting charges	xx		
To printing & stationery	xx		
To medicines, injections, etc	xx		
To telephone charges	xx		
To depreciation	xx		
To institute fees	xx		
To seminars and conferences	xx		
To miscellaneous expenses	xx		
To surplus (balancing figure)	xxx		

Balance Sheet as on _____

Liabilities	Amount	Assets	Amount
Capital xxx		Furniture xxx	
Add: Surplus xx		Less: Depreciation <u>xx</u>	xxx
Less: Drawings <u>xx</u>	xx	Work-in-Progress	xx
Loan from bank	xx	Bank balance (Client's)	xx
Client's deposits	xx	Bank balance (office)	xx
Liabilities for expenses	xx	Cash	xx
Fees collected in advance	xx		
Total	xxx	Total	xxx
