



# St. Lawrence High School



A Jesuit Christian Minority Institution

Study Material 3

Sub: ACCOUNTANCY

Class 11

Chapter: Unit 1: Introduction to Accounting

Date: 01/07/2020

Topic: Basis of Accounting 1

## **Basis of Accounting**

Method of Accounting is classified in three categories such as-

- Cash Basis
- Accrual Basis
- Hybrid Basis

## **Cash Basis of Accounting**

Cash basis of accounting is a method of accounting in which transactions are recorded in the books of account when cash is actually received or paid and not when the transactions take place. This method recognizes revenues and gains when cash is actually received. Similarly, it recognizes expenses and losses when cash is paid.

Advantages:

- (1) Transactions are recorded only when all phases of transactions are complete.
- (2) Recording of transactions are simple.
- (3) This method does not require estimate and judgements of the accountant.
- (4) Reliability of accounting information is increased.
- (5) This method reflects actual inflow and outflow of cash.

Disadvantages:

- (1) This method of accounting is inappropriate for most businesses.
- (2) It does not take into account fixed assets, debtors, creditors, inventories, prepayments, accrual etc.
- (3) No Trading, Profit and Loss Account and Balance Sheet can be prepared.
- (4) Generally Accepted Accounting Principles do not recognize this basis.
- (5) An accurate view of the trend of the periodic income cannot be provided.

Problem 1: Mr. X has provided the following information for the year 2019. You are required to calculate his net income under cash basis:

Fees received in cash	Rs. 35,100
Rent of chamber paid	Rs. 10,800

Rent of chamber paid in advance (included in the above)	Rs. 800
Fees accrued but not yet received	Rs. 2,000
Salary paid	Rs. 5,400
Salary outstanding	Rs. 500

Solution:                                      Computation of Net Income of Mr. X under cash basis  
For the year ended 31<sup>st</sup> December, 2019

Particulars	Amount (Rs)	Amount (Rs)
Fees received in cash		35,100
Less: Expenses paid in cash-		
Rent paid	10,800	
Salary paid	5,400	16,200
Net income under cash basis		18,900

### **Accrual Basis of Accounting**

Accrual basis of accounting is an accounting system which records revenues and expenses as they are earned or incurred, not as cash received or paid respectively. This basis of accounting arises from the concept of periodicity. A business follows accrual basis of accounting of income and expenses are measured when the transactions take place, without taking into consideration inflow and outflow of cash. Profit, under accrual basis of accounting, is the excess of revenues over expenses for a given accounting period. But the receipts of incomes or payments of expenses may be related to a different accounting period. Therefore, profit of an accounting period does not reflect cash receipts and cash payments of that period. For proper matching of expenses against revenues, this method takes into account prepayments and accruals.

Advantages:

- (1) This method is widely used by most businesses.
- (2) Trading, Profit and Loss Account and Balance sheet can be prepared.
- (3) Generally Accepted Accounting Principles recognize this basis of accounting.
- (4) An accurate view of the trend of periodic income can be provided.
- (5) It helps comparison of accounting statements.

Disadvantages:

- (1) This method is not simple.
- (2) It requires estimates and judgements of the accountant. Therefore, accounting practice may be inconsistent.
- (3) It is possible to adopt a variety of accounting principles and procedures.
- (4) This method does not reflect the actual inflow and outflow of cash.
- (5) It is not suitable for any organization where realization of income is doubtful.

Problem 2: Taking information of Problem 1 calculate net income under accrual basis.

Solution:                                      Computation of Net Income of Mr. X under accrual basis  
For the year ended 31<sup>st</sup> December, 2019

Particulars	Amount (Rs)	Amount (Rs)
Fees received in cash	35,100	
Add: Fees accrued but not yet received	2,000	37,100
Less: Expenses:		
Rent paid	10,800	
Less: Rent paid in advance	800	10,000
Salary paid	5,400	
Add: Outstanding salary	500	5,900
Net Income		21,200

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