

Three Sided Accounting System

**Abhinav Upadhyay,
Assistant Professor,
Amity University**

Abstract

Double entry system of accounting and the financial statements generated from the books of account maintained on such system have inherent limitations. One of the important limitations of double entry system is the omission of non-financial transactions. In the present scenario there is a need to have a superior system of accounting which will consider not only such non-financial transactions but will also consider the other quantifiable data which will make these financial statements more meaningful. In this article, an effort has been made to discuss a potential new system of accounting, which can be called 3-dimensional system of accounting which will consider all three types of transactions namely; Category I - Transactions having only monetary effect; Category II - Transactions having monetary as well as quantity [3D] effect. The article also deals with a number of such areas where the presentation of financial statements will become more reliable and compliant with statutory requirements by applying the new method of accounting.

Keywords: Double entry system, Financial Accounting, New Accounting Method.

Introduction

Presently we follow “Double Entry system of book keeping” for financial accounting. The double entry system is like 2-dimensional system, where we look at the transactions only from monetary angle and apply the accounting rules of Real, Personal and Nominal Accounts. In fact, many transactions actually have three dimensions, except some transactions involving pure cash flows. The 3rd dimension of these transactions is some other quantifiable effect which gets omitted from being recorded.

With the help of accounting standards, ERP systems or other measures, in some cases we overcome this limitation while recording transactions and then while presenting financial statements. Can an effort be made to improve the accounting system itself which will automatically generate the necessary data for presenting the same in the financial statements? If the basic principles of accounting are suitably amended and the 3rd dimension is allowed to be recorded in the books, can the desired result be achieved?

Limitation of Financial Accounting

Traditionally we have been recording only those accounting transactions which can be measured in monetary terms. We overlook the non-monetary transactions which have other quantifiable

angles and we will find a number of important quantifiable transactions which are not reflected in the financial statements merely because they have no monetary value.

Since these transactions are not recorded in the books of account, they do not get reflected in the financial statements generated out of these books of accounts. We have a number of accounting standards which take care of such omissions. But since the transactions are omitted from books of accounts, separate records need to be kept, leading to increased work and also leaving a possibility of omission of some important data.

What are Other Quantifiable Dimensions?

Stock items have this measurable dimension as 'kgs.', 'litre', 'meter', etc. Investments have number of 'shares' or 'units', and shares or debentures of the company (shown under Share Capital/Secured Loans) have 'number' as the third dimension. Land & Building has 'area' as the third quantifiable dimension. Plant & Machinery can be presented in production capacity or power, Furniture in area or storage capacity, Vehicles in cubic capacity or mileage, etc. Assets measured from this angle will definitely add value for the reader. Land purchased 30 years back and land purchased now will have same benefits but the cost will vary drastically. If a balance sheet shows one acre of land acquired 30 years back at R10,000 and another acre of land purchased recently for R50,00,000 separately, will definitely give better picture about the market value of the assets.

Balance Sheet Assets side (now)

Particulars	Amount (R)
Land	50,10,000

Balance Sheet Assets side (what should appear)

Particulars	Qty.	Amount (R)
Land	1 Acre	10,000
	1 Acre	50,00,000

(Here, we are not touching the historical cost concept but just segregating the assets according to its acquisition time, place, etc.)

Traditionally we have been recording only those accounting transactions which can be measured in monetary terms.

We overlook the non-monetary transactions which have other quantifiable angles and we will find a number of important quantifiable transactions which are not reflected in the financial statements merely because they have no monetary value.

Nominal accounts can also be quantified wherever possible. Number of employees, quantities of materials consumed, number of units for power consumption, area occupied for Rent, Rates, Taxes, etc. are some examples which if shown in Profit and Loss Account will add value.

For example, electricity rates differ for different types of connections or from state to state. With the data of units consumed, one can find out the extent of variation in expenses on account of consumption and on account of rates. You will appreciate that consumption is

controllable whereas, rate is not. Necessary data is available in the electricity bill received from the electricity supply company but is not recorded and thus does not become part of books of account.

Take example of earned leave granted to employees. As per the service rules particular number of days leave is credited to employees account on the first day of the year, which he can avail anytime during the year and the un-availed leave is carried forward subject to certain limit. On the balance sheet date such un-availed leave days are not reflected on the liability side. We make a provision for leave encashment but it does not show the number of paid man-days the company is going to lose in future.

This is just a sample list of items. You will find many more items where the 3rd quantifiable effect can be recorded.

Types of Transactions (Monetary As Well As Non-Monetary)

After having understood the 3rd dimension for a number of transactions, we can now group various transactions into three categories, namely:

- Category I - Transactions having only monetary effect;
- Category II - Transactions having monetary as well as quantity [3D] effect;
- Category III - Transactions having only quantity [3D] effect.

In the traditional double entry system of book keeping, we record only the transactions in the first category in the books of account.

Transactions in the second category are recorded only to the extent of their monetary effect. We, however, in some cases like stock, do record the third effect as separate costing records.

However, the transactions in the third category, how-so-ever important, are not recorded in the books of account merely because they have no monetary value.

In the proposed new system of accounting (let's call it 3-dimensional accounting system) an effort is made to recognise the transactions in Category II and III. Once recorded in the books of account, it would be possible to reflect the same suitably in the financial statements namely Balance Sheet and Profit and Loss Account.

Implementing 3-dimensional system in phased manner will facilitate its smooth transition over double entry system. Again, the extent to which the 3-dimensional system to be implemented may differ from organisation to organisation.

While proceeding further with the 3-dimensional method of accounting, you will recollect many Category II and III transactions worth recording. We can deal with each one of them as we progress further with this method. Let us quickly see some examples where that third dimension remains unrecorded.

Category II Transaction

When we purchase goods, we debit "Purchase Account" (a nominal account) and the same ultimately is shown in the Profit and Loss Account. Actually, when we purchase goods it should

be reflected as Stock (Real Account) in the Balance Sheet and should be debited to Profit and Loss Account only when and to the extent consumed.

When we fill petrol in vehicle, we debit “Petrol/ Conveyance Account” (nominal account) when there is no expense but an asset (Cash) is replaced by another asset (Petrol, quantifiable in litres). The real expenditure occurs only when we consume that fuel. One may argue that it fits into materiality concept and continue to follow the present accounting treatment. It will be very difficult to actually calculate the consumption of fuel on daily basis and charge to expense account. Effort here is just to point out the real nature of transaction and accounting convenience that is followed while recording the transactions.

When we recharge our prepaid mobile, we debit the Telephone Expenses Account (Nominal Account). Actually we are buying ‘talk time’ by making payment in monetary terms. The asset (cash) changes to an intangible asset ‘talk time’ (quantifiable in hours). The real expenditure occurs when we use that ‘talk time’. One may again ignore the same from materiality point of view.

But when we debit Purchases Account (nominal account) when we are actually purchasing Stock (real account), it is worth considering seriously. Our present double entry system ignores all the important transactions of transition from raw materials to finished goods and directly records the final transaction of sales. Due to this, we need to value stock at the end of the financial year so that it can be shown in the Balance Sheet assets side by, credited to Trading Account. Showing opening stock and purchases on debit side and closing stock on credit side gives the net effect of materials consumed. What should actually be recorded is the consumption of materials generated out of books of account. When we calculate the closing stock, excess, shortage, pilferage, etc. can accordingly be recorded. Presently, some accounting software allow such type of recording. But the effect in Profit and Loss Account and Balance Sheet is given as per the traditional double entry system.

Category III Transaction

When a company issues bonus shares, no accounting entry is passed in the books of the investor as no monetary transaction is involved.

When an employee avails earned leave of one day, the employer actually is put to loss of the output of that employee for that day. But transaction is not recorded in the books of account. What is recorded at the end of the year is a provision for Leave Encashment. When we will start recording these transactions in the books of account, an authentic data will be readily available in the books itself.

In case of demerger of company, both split companies may issue shares to the shareholders without involving any financial implication. This transaction cannot be recorded in the books of account of the investor merely because there is no financial implication. While showing investments in the Balance Sheet, one will have to give special attention to such transactions as the same do not emerge out of books of account. Those who audit the accounts of brokers and sub-brokers or investor having huge investments will appreciate that it becomes very difficult to reconcile the share balances as appearing in the books that with the demat account.

Benefits of 3-Dimensional Method of Accounting

The 3-dimensional system, if brought into place, can -

- i) Improve the accounting system to bring it at par with the changing scenario;
- ii) Improve the presentation of the financial statements to give a holistic view to understand the true assets and liabilities whether having monetary value or otherwise;
- iii) Will facilitate better understanding of the accounting records and financial statements not only from financial angle but from various angles.

