

Cash v Accrual Method

An organization will **report** transactions differently when using either the *cash* or *accrual* method of accounting. The cash method typically only requires a transaction to be reported if cash has traded hands, although some exceptions exist. Even where the cash method is followed, a small business will usually want to keep a record of accrual activity within a bookkeeping or practice management software program. Since small businesses tend to always want to keep a record of accrual activity, i.e., accounts receivable or payable, the accounting system may house information needed to report amounts either according to the cash or accrual method. The accrual method looks at the economic substance of an event when determining when to report a transaction. If cash does not trade hands at first, then an initial journal entry is used to record the economic event, and then another journal entry is recorded later when cash is finally exchanged. A software program usually contains an easy mechanism to switch back and forth between generating reports according to either method. For example, the bookkeeping program Quickbooks® allows users to switch back and forth between reports generated according to the cash or accrual method. The following tables outline the differences between the cash and accrual method according to each major type of account.

INCOME STATEMENT

NET PROFIT	CASH	ACCRUAL
Revenues	When cash trades hands, money is received in the mail or in person, or a charge card is swiped	When the economic substance of a transaction has been rendered by the organization or cash trades hands
Expenses	When cash trades hands, money is put in the mail or handed to a person, or per the charge card statement	When the economic substance of a transaction has been rendered by a vendor or cash trades hands
Gains/Losses	The same as for revenues and expenses	The same as for revenues and expenses

✓ Net profit is carried over to the statement of retained earnings.

STATEMENT OF RETAINED EARNINGS

RETAINED EARNINGS	CASH	ACCRUAL
Net Profit	<i>As carried over from the income statement</i>	<i>As carried over from the income statement</i>
Distributions	When cash is distributed to owners	When cash is distributed to owners or an obligation has been properly established

✓ Net profit less distributions is carried over to the equity section of the balance sheet.

BALANCE SHEET

ASSETS	CASH	ACCRUAL
Cash and cash equivalents	When cash trades hands	When cash trades hands
Investments	When cash trades hands	Normally, when cash trades hands, but an asset account may be needed to record interest or dividends receivable
Accounts receivable	Generally not used except for employee advances and prepaying a credit card	When the economic substance of a transaction has been rendered by the organization, but not yet paid in full
Inventory	Generally not used unless following applicable tax rules	When an item meant for resale has been purchased with cash or on account—several methods (specific identification, LIFO, FIFO) determine how much expense to keep as inventory
Prepaid expenses	Generally not used unless following applicable tax rules	Prepaying an expense in advance; keep the amount until the vendor renders services
Note receivable	When amounts are lent and then again when loan payments are received	When amounts are lent and loan payments are received, except if loan payments apply to more than one time period, then an asset account may be needed to record any interest receivable
Fixed Assets	When the asset is purchased—a loan payable will usually get established if purchased using borrowed funds	When the asset is purchased—a loan payable will usually get established if purchased using borrowed funds
Accumulated depreciation	Per the depreciation method	Per the depreciation method
Intangible assets	When the asset is purchased—a loan payable will usually get established if purchased using borrowed funds	When the asset is purchased—a loan payable will usually get established if purchased using borrowed funds
Accumulated amortization	Per the amortization method	Per the amortization method

LIABILITIES	CASH	ACCRUAL
Accounts payable	Generally not used except for a postdated check, negative bank balance, and unpaid credit card balance	When the economic substance of a transaction has been rendered by a vendor, but not yet paid in full
Accrued expense	Not used	When the economic substance of an obligation has been established, but not yet paid in full
Unearned revenues	Not used	When a transaction has been paid for in advance, but the economic substance of the services have not yet been rendered by the organization
Long-term debt	When amounts are borrowed and then when loan payments are made	When amounts are borrowed and loan payments are made, except if loan payments apply to more than one time period, then a liability account may be needed to record accrued interest
Obligations under capital leases	When a lease “looks like” a loan—treated similar to long-term debt	When a lease “looks like” a loan—treated similar to long-term debt

EQUITY	CASH	ACCRUAL
Owner’s equity	When capital (money) is contributed into the organization	When capital (money) is contributed into the organization
Paid-in capital	Contributions in excess of the par value of stock; applies to corporations only	Contributions in excess of the par value of stock; applies to corporations only
Retained earnings	<i>As carried over from the statement of retained earnings</i>	<i>As carried over from the statement of retained earnings</i>