

Visual Learning Maps

Introductory Financial Accounting



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VIRTUAL TEXT BOOK

ACCOUNTING – CASH & ACCRUAL METHODS – 1 OF 1

Cash Method

The question arises from time to time – “Why not account for the business on the basis of only cash received and paid? Bookkeeping entries would only be made when cash is received or paid. Under this method revenue and expense would be recorded ONLY when cash moves.

But, revenue and expense occur as economic realities through credit transactions when cash has not moved – in these types of transactions:

- Invoices issued to customers will increase revenue and increase accounts receivable
- Invoices received from suppliers will increase expense or assets, and will increase accounts payable

This method violates Generally Accepted Accounting Principles because

1. Revenue is not recognized when it is earned;
2. And expenses are not matched with revenue earned in the same time period.

Financial statements resulting from using the Cash Method are not accurate. Readers cannot rely on this financial information. Assets, liabilities, revenue and expense amounts would be wrong – which would make equity wrong. There is nothing left on the financial statements that would be correct.

Accrual Method

The Accrual Method recognizes the reality that transactions have occurred even though cash has not moved. Revenue is recorded when it is earned; expenses are recorded when they are incurred **whether or not cash has moved** (see credit transaction listed above). Revenue and expense are matched in the same time period to provide an accurate measurement of net income.

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