Accrual basis and cash basis measure of performance Harvard Case Solution & Analysis

Accural Accounting

- Revenue are recognized on the income statement when they are earned but not necessary received. Balance sheet is affected at the time of transaction.
- Accruals are adjustments for revenues that have been earned but are not yet recorded in the accounts, and expenses that have been incurred but are not yet recorded in the accounts.

Example

- An example of an accrual for revenue involves your electric utility company. The utility used coal and many employees in December to generate electricity that customers received in December. However, the utility doesn't bill the electric customers for the December electricity until the meters are read in January. To have the proper amounts on the utility's financial statements, there needs to be an adjusting entry to increase revenues that were earned in December and the receivables that the utility has a right to as of December 31.

Video

SIDE A

CONCLUSION

- The main difference between accrual and cash basis accounting is that the cash method is most used by small businesses and for personal finances. The cash method accounts for revenue only when the money is received and for expenses only when the money is paid out.
- On the other hand, the accrual method accounts for revenue when it is earned and expenses goods and services when they are incurred. The revenue is recorded even if cash has not been received or if expenses have been incurred but no cash has been paid. Accrual accounting is the most common method used by businesses.

SIDE B

Cash Basis Accounting

- Revenue is recognized when cash is received and expense is recognized when cash is paid.
- When an exchange is complete then it is recorded, not before.
- It is simpler and cheaper to do but it makes obtaining financing more difficult due
- to inaccuracy.

Example

- or example, if a florist sells dozens of flower arrangements at the end of March to another small business and extends 15-day payment terms, the florist may not receive payment until April. The florist paid for the flowers, the labor and other business expenses related to filling the order during March. On the florist's income statement, the expenses are recorded during March, but the income relating to the expenses are recorded during April

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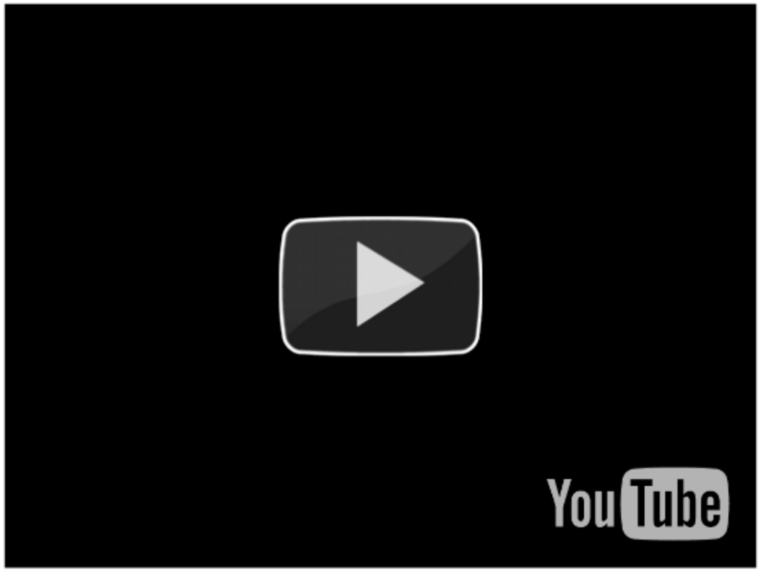

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