What is the difference between cash vs. accrual basis accounting?

In order for businesses to establish the best bookkeeping practices and to minimize their tax burden, they must be fully aware of the limitations and differences between being on a cash vs. accrual accounting basis.

The Cash Basis of Accounting
Under the cash basis of accounting, income and expenses are recorded only when they are actually received. Any receivable revenue is not considered income until the money is received, and any payable expenses are not recorded until the money is paid out. In order for a business to be able to use the cash basis of accounting, they must have sales under $5 million per year. Additionally, the cash basis cannot be used by businesses that are required to keep track of their inventory (over a threshold value). The cash basis of accounting significantly simplifies the daily accounting processes. Cash basis provides options to postpone revenue and accelerate expenses to reduce overall tax liability. A drawback to cash basis accounting is that it can misrepresent your company’s financial position since it ignores transactions where cash is yet to be exchanged.

The Accrual Basis of Accounting
The accrual basis of accounting records income and expenses when they are earned. This accounting method records receivables as income from the moment the service or goods are delivered, and records payables as expenses from the moment the expense is incurred, regardless of when money is received or paid. The accrual basis of accounting is the best method to represent your company’s financial position since it does a better job at matching income with expenses.

What’s Best for Your Small Business?
The cash method of accounting is the easier of the two to use and maintain, since it’s pretty straightforward. The cash method gives you a better picture of the funds in your bank account, while the accrual method accounts for money that’s yet to come in. The cash basis gives you an immediate look at your financial picture, while the accrual basis is more of a long-term view.

Stride Advisors can guide you on the decision from a financial management and tax standpoint.

Options for the small business owner

- Small businesses can choose between cash and accrual accounting
- Large businesses must use accrual