



## **Accrual vs. Cash**

### **Jim Huston, Venture Mentors**

Both Accrual and Cash are GAAP accepted accounting methods for small business. Only the Accrual method is acceptable for large businesses. Because of Social Security Administration's (SSA) treatment of income from self-employment, one method may be advantageous over the other.

#### **Cash**

In the Cash method of accounting the business is run like a checkbook. When goods and services are purchased and paid for, they are recorded. When products are sold and the cash collected, they are recorded as sales. An example of the cash basis would be a sale of goods in January, but the money is not received from the customer until February. Under the Cash Basis of accounting, this would be considered income in February. If attendance at a trade show was planned for May but had to be paid for in March, in a cash basis accounting it would be expensed when it was paid for in March. This method of accounting slightly favors people on Supplemental Security Income (SSI). Money that has not been received does not decrease the SSA benefit checks. The controls and comparability of financial statements is not as good as with accrual accounting. Money can be spent in one period for materials or labor while the profit from the activities is not recognized until another month. There are some ways to control income in a cash method of accounting.

#### **Accrual**

In the Accrual method of accounting transactions are recorded when they happen rather than when the money is received or paid. This makes the accounting slightly more difficult because you are dealing with goods that have been purchased but not paid for and sales that have been made but the cash has not been collected. If there is a large expense benefiting multiple months the expense can be spread evenly over the months. Returning to the example of the sale in January listed in the section above. The sale would be recorded in January so that it matched when the expenses occurred. The receipt of cash in February is just a receipt of cash and is not a sale. In the trade show example above, the business would recognize the expense in May or could even spread the cost over the months when they expected increased sales due attendance at the trade show. This accounting method is required for people on Social Security Disability Income (SSDI) benefits. It is also a favorable accounting treatment for people on SSDI. The expense and income are matched to the same period.

The following is a table which shows the effects of cash and accrual methods on income and expense. The scenario is the trade show. The trade show must be paid for in March for attendance in May. The cost is \$2,000. At the show \$4,000 in merchandise is sold. The cost of the merchandise is \$1,000. All money is collected 30 days later.



Activity	Month	What Happens		Income Effect	
		Cash	Accrual	Cash	Accrual
Pay for show	March	\$2,000 in expense	\$2,000 in prepaid	(\$2,000)	\$0
Attend Show	May	\$0 Already expensed	\$2,000 expense	\$0	(\$2,000)
Sales Amount	May	0 collected	\$4,000 sales	\$0	\$4,000
Travel to Show	May	(\$500) expense	(\$500) expense	(\$500)	(\$500)
Cost of Sales	May	(\$1,000) in cost	(\$1,000) in cost	(\$1,000)	(\$1,000)
		<b>May Income</b>		<b>(\$1,500)</b>	<b>\$500</b>
Receive Cash	June	\$4,000 collected	\$4,000 collected	\$4,000	\$0
		<b>Total Income</b>		<b>\$500</b>	<b>\$500</b>

Using the accrual method there is one month with \$500 income. Using the cash method there are two months with losses, because those are the months when expenses were paid. In the cash basis there is one month when \$4,000 is counted as income. In the final analysis, the overall position of the Company is the same however using the accrual method the person does not exceed Substantial Gainful Activity (SGA).



Venture Mentors, LLC

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**JIM HUSTON, CPA**

*President*

708 Cherokee Woods Rd. Louisville, KY 40206

phone (502) 930-2079 fax (502) 896-6876

e-mail jim@venturementors.biz