

# Accounting Methods - Cash Basis and Accrual Basis

Congregational treasurers may wonder how to most effectively record the congregation’s financial transactions and communicate its financial condition. When dealing with congregational financial matters, one primary interest is accessibility of financial data. Financial transactions should be recorded in such a way that a bookkeeper or successor treasurer will be able to both understand historical data and consistently process new transactions. Additionally, financial statements should be presented in such a way that they are easily comprehended. A congregation’s financial condition needs to be clearly understood by lay and rostered leaders, ministry partners and other interested parties.

In evaluating the needs of a particular congregation, it is important for the congregation’s leadership to determine its preferred method of accounting. Certain external requirements (e.g., external audits or loan covenants) might necessitate a particular method of accounting. Absent such requirements, however, a congregation may choose to account for financial activities using either cash or accrual methods. Some organizations choose to implement a modified cash method, a hybrid that accounts for short-term assets using the cash method and long-term assets using the accrual method.

The accrual method is the only method of accounting that conforms to the provisions of Generally Accepted Accounting Principles (GAAP) in the U.S.A. This method provides the most information regarding the financial status of an organization. However, the accrual method of accounting can be more complex than other methods and often requires more robust accounting software and technical expertise. Factors and implications that can impact the choice of accounting method include: a) financial expertise of both preparers and recipients of financial data; b) sophistication and availability of accounting software; and c) external reporting requirements.

The process of choosing an accounting method should involve several congregational leaders, including some individuals who are not directly involved with financial management. Involving a variety of stakeholders may facilitate a transparent decision-making process as well as create an opportunity for financial education.

The following chart provides a comparison of the cash and accrual methods of accounting, highlighting some benefits and challenges with each method:

	<b>Cash Basis</b>	<b>Accrual Basis</b>
Definition	Accounting method in which income is recorded as cash is received and expenses are recorded when cash is paid	Accounting method in which income is recorded when earned and expenses are recorded when incurred, regardless of cash flow
Compliance with GAAP	Does not meet GAAP requirements	Meets GAAP requirements
Advantages	Generally, an easier method for smaller entities; for entities that conduct business primarily in cash, this method sometimes provides adequate information to monitor financial condition	Provides more information regarding income and expenses of an entity; accounting for outstanding commitments and prepaid cash receipts, this method allows for more accurate measurement of net income/(loss)

	Cash Basis	Accrual Basis																																																												
Challenges	May offer a misleading financial picture if an organization has unpaid expenses, outstanding receivables and/or cash receipts that are unavailable for immediate use	Generally, more complicated and expensive method; this method still necessitates a process to monitor an entity's cash position and cash flow																																																												
<b>Comparative Examples</b>																																																														
Revenue: \$1,000 grant award designated to cover a two-year period (payment received in year 1)	In year 1, record entire grant as increase in cash and revenue	In year 1, record cash receipt and half of grant revenue; recognize half of the grant as income in year 2																																																												
Revenue: \$1,000 grant award designated to cover a two-year period (payment received in year 1)	In August of year 2, record outstanding May bill as increase in expense and reduction in cash	In May, record electric bill as increase in expense and accounts payable; in August of year 2, record decrease in cash and accounts payable																																																												
Financial Statement Impact (transactions limited to comparative example transactions above):	<table> <thead> <tr> <th></th> <th>Year 1</th> <th>Year 2</th> </tr> </thead> <tbody> <tr> <td colspan="3"><u>Balance Sheet</u></td> </tr> <tr> <td>Cash</td> <td>\$1,000</td> <td>\$500</td> </tr> <tr> <td>Accounts Payable</td> <td>-</td> <td>-</td> </tr> <tr> <td>Deferred Revenue</td> <td>-</td> <td>-</td> </tr> <tr> <td>Net Assets</td> <td>\$1,000</td> <td>\$500</td> </tr> <tr> <td colspan="3"><u>Income Statement</u></td> </tr> <tr> <td>Revenue</td> <td>\$1,000</td> <td>-</td> </tr> <tr> <td>Expense</td> <td>-</td> <td>\$(500)</td> </tr> <tr> <td>Net Income</td> <td>\$1,000</td> <td>\$(500)</td> </tr> </tbody> </table>		Year 1	Year 2	<u>Balance Sheet</u>			Cash	\$1,000	\$500	Accounts Payable	-	-	Deferred Revenue	-	-	Net Assets	\$1,000	\$500	<u>Income Statement</u>			Revenue	\$1,000	-	Expense	-	\$(500)	Net Income	\$1,000	\$(500)	<table> <thead> <tr> <th></th> <th>Year 1</th> <th>Year 2</th> </tr> </thead> <tbody> <tr> <td colspan="3"><u>Balance Sheet</u></td> </tr> <tr> <td>Cash</td> <td>\$1,000</td> <td>\$500</td> </tr> <tr> <td>Accounts Payable</td> <td>\$(500)</td> <td>-</td> </tr> <tr> <td>Deferred Revenue</td> <td>\$(500)</td> <td>-</td> </tr> <tr> <td>Net Assets</td> <td>\$0</td> <td>\$500</td> </tr> <tr> <td colspan="3"><u>Income Statement</u></td> </tr> <tr> <td>Revenue</td> <td>\$500</td> <td>-</td> </tr> <tr> <td>Expense</td> <td>\$(500)</td> <td>-</td> </tr> <tr> <td>Net Income</td> <td>\$0</td> <td>\$500</td> </tr> </tbody> </table>		Year 1	Year 2	<u>Balance Sheet</u>			Cash	\$1,000	\$500	Accounts Payable	\$(500)	-	Deferred Revenue	\$(500)	-	Net Assets	\$0	\$500	<u>Income Statement</u>			Revenue	\$500	-	Expense	\$(500)	-	Net Income	\$0	\$500
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