

COMPARATIVE STUDY ON ACCOUNTING MODELS "CASH" AND "ACCRUAL"

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ABSTRACT: Accounting, as a source of information, can recognize the economic transactions taking into account the time of payment or receipt thereof, as soon as they occur. There are two basic models of accounting: accrual basis and cash basis. In the cash accounting method the transactions are recorded only when cash is received or paid, shall not make the difference between the purchase of an asset and the payment of expenditure – both of which are considered "payments". Accrual accounting achieves this distinction, as recognized accounting transactions as soon as they occur. At the same time, accrual accounting method ensure accurate submission of transactions, but in order to determine cash flow is necessary to apply cash accounting method. In the cash basis, revenues and expenses are reported in the period in which the payment is made or the income is received, whereas, and on the basis of accrual-based accounting method, income is expressing the effect achieved with the effort called expenses. In order to research the opportunities of information provided by the two accounting models in this study – by applying a methodology of research subscribed to the constructivist current and based on a vast practical experiences in accounting activities that apply both models of accounting - we achieved a SWOT analysis with exposing the strengths and weaknesses of the two accounting models highlighting the convergence and divergence between them.

Keywords: "cash basis"; "accrual basis"; cash flow; income received; expenses paid.

JEL Codes: M41

Generally Introduction

This paper is a preamble of our research on accounting "cash" and "accrual" models, research started to find ways to use them by entities from Romania, and the improvement of the two models.

The objective of this paper is to put face to face two accounting models, to seek arguments for using a model or the other by their SWOT analysis.

Modern financial accounting has emerged from a long tradition regarding the registration of receipts and payments of cash, known as the single-entry bookkeeping. The double-entry accounting was interested in resources rather than in profits. The medieval administrators have kept accounting records not for the sake of the entity but, rather, for the control of assets they have under management. There was no clear distinction between capital and income, no cost accounting designed to impose a discipline on the valuation of assets and their depreciation method.

Keeping double entry accounting arose out of the need for traders-Italian bankers of recording the receivables. The vital interest represents the future, words of responsibility being "you give, you take". The Summa Arithmetic of Luca Paciolo in 1494 does not put an end to cash basis. Although it presents the base of double entry system, in his own time and for centuries after, many

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entities have kept doing the simple entry, highlighting unique records, but little more than lists of receipts and payments, the double-entry bookkeeping is much said.

Due to the sporadic nature of transactions, due to the fact that the profit margin was different from one transaction to another, because of the existence of the risk of non-collecting customers, traders preferred to open separate accounts for each batch of goods and to leave open each account until the full sale of the goods in question. At the close of a group account, the balance was transferred to profit and loss, which may then, at longer ranges were transferred to the capital. In each case, the profit was considered when the entity was liquidated.

The accrual accounting method is a fair review of transactions, but for the determination of the cash flows is necessary to apply cash accounting method.

"Accrual" accounting requires recognition of income when it is earned, and expenses when they are incurred, without taking account of the time of receipt or payment of cash. Some small entities- individual taxpayers use a strict or modified approach of cash basis, recording the income only when they receive the cash and the expenses just when the payment is made.

Methodology of Research

Our research is based on practical experience in accounting and it is subscribed to the constructivist current because the object of our research is to explain certain facts, and in the case of our study, the two models of accounting used by economic entities.

Using the tools needed to achieve the objective of our research, we started out to inform us about the two models using the descriptive research method as a method of research, as a way of knowing those two models of accounting, as well as a preliminary study for generating information and explanations. The documentation consisted of specialized bibliography: books and journals, regulations, research reports of the relevant professionals, doctoral theses and last but not least the sites of internal and international organizations specialized in the field of accounting.

At the same time we use the comparative method to identify any differences or similarities in the use of accounting models listed, highlighting the strengths and vulnerabilities of the accounting models "cash" and "accrual".

Connotations and comparative approaches

Literature review

In his doctoral thesis – "From the accrual accounting model to cash accounting model in the management of controlled resources," Mrs. Baban Cristina - Lucia (2010) presents the accrual basis as generally accepted for recognition of economic transactions in the accounts when they occur and not when comes the time of payment or collection. The exception to this rule is the use of cash flows, which are based on the cash basis.

Because in the accounting world, sometimes "it holds that the profit is a point of view, while the cash is a reality" (Gîrbină M.M and Bunea S, 2008, page. 8), the interest of the majority of users of accounting information is directed towards its cash.

The initial approach of the concept of accrual highlights the idea of recognition of income in the period in which they were earned, the goods were supplied or the services rendered, without conditioning their collection. Recognition of revenue is linked to the recognition of costs which have determined the realization of income, leading to the establishment of an economic result when it is generated. (Lungu C.I. 2007, page. 239)

From the perspective of the history of Romanian accounting regulations, it should be noted that the accounting regulations applicable to large firms up to 31 December 2005 present both terms in the same paragraph, as a takeover of the accounting principle of the Fourth Directive European and as a reception from the regulations of the IASB of the concept of accrual basis. The general regulations for the preparation of the financial statements prepared by the IASB requires elaboration of financial statements based on accrual accounting model as reflecting the best the entity's goal

and objective, to provide information on financial performance, financial position and changes in financial position of the entity.

Treasury Accounting Method

The treasury accounting model – the "cash" basis method is defined as a key in assessing real property of the company as it seeks recognition of the main operation through the prism of treasury, the treasury meaning both cash and cash equivalents.

The management team, through its policies, must watch the cash flow through the prism of the flows obtained from the core business and their use, the cash out being directed for investment and financing activities.

However, there is a possibility that the entity will gain profit but this is to be found only to a limited extent in its cash. Therefore, it is necessary to use certain adjustments to convert the result of the company determined on the basis of accrual accounting in a result which reflect receipts and payments.

We must recognize that the cash is a key indicator in the assessment of an entity's management, both short-term and long-term, offering information on financial stability, the risk of bankruptcy, the signs of vulnerability, etc.

“Accrual” Accounting Model

The concept of accrual basis in the European accounting, it is interconnected with *the principle of delimitation in time* or *the principle of the independence of the financial year*, a principle that is the base of the preparation of the financial statements of an entity. This principle requires that revenue and profits, and their costs to be accounted in the same financial year, the Statement of cash flows being the one that shows the receipts and payments effected during the financial year.

The revisions adopted in 2003-2004, the IASB has reformulated the concept of accrual basis, by recording in accounting of assets, liabilities, equity, income and expenses at the time when fulfilling its conditions for recognition in the accounts, provided in the regulations regarding the preparation and presentation of financial statements, complementing the strict reference regarding the recognition of income and expenses.

Comparative presentation of accounting recognition in the case of "cash" and "accrual" models

The contrasting characteristics between the two accounting models are obviously focused on the accounting recognition of revenue and expenses. Thus, in cash basis, *revenues* are recognized in the accounting period in which the *payment* is received, and *the expenses* in the period in which the *payment* is made.

In accrual basis, to account *the revenue* represents to express the effect of the economic activity accomplished with the effort represented by expenses. According to the general regulations for the preparation of the financial statements prepared by the IASB, the income means increases in economic benefits in a given accounting period, in the form of growth of assets and reduce debts, resulting in increased equity other than by the contribution of the shareholders; the expenditure represents decreases of the economic benefits, in a certain period of time, in the form of decrease in assets and increase in debt, resulting in decrease of equity other than through distribution to shareholders. (Gîrbină M. and Bunea S, 2007, page. 44-45)

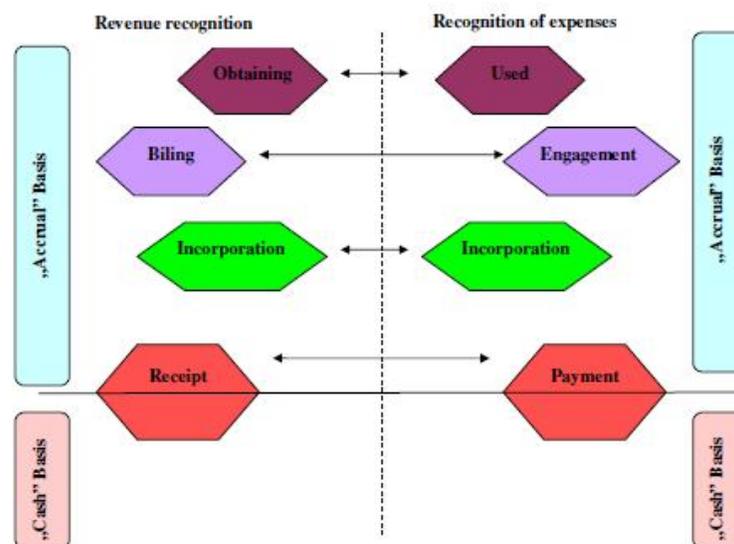


Figure no.1. - Accounting recognition of incomes and expenses on the basis of the two accounting models.

Source: Authors' contribution

In Figure no. 1 are presented the moments of recognition in accounting of revenue and expenses based on the models "Cash" and "Accrual". It is obvious that, in the accrual basis, it is distinguish the existence of three moments of recognition of revenue and expense accounts, moments that can be put in correspondence or in the mirror:

- revenues are recognized in accounting at the moment of getting its own production on the basis of expenditure generated by consumption of resources (materials and supplies, wages, etc.);
- revenues are recognized in accounting at the moment of billing, when it is generating receivables from the beneficiaries of the goods or services, and, in a same way the payables requires recognition of a debt to the supplier of goods or services;
- both revenue and expenses are included in the result of the financial period.

It is found that there is a moment of recognition of revenue and expenditure which coincides in both models of accounting. This is the payment respectively receipt. The difference is that, if in the cash basis, *only* receiving cash represents income and *only* payment represents expense, in the accrual basis, the payment, respectively collection represents the fourth moment of the recognition of income and expenses. This is because, in the accrual basis not all cash receipts can be recognized as revenue, and not all payments can be recognized as expenditure. As an example is the payment of dividends which cannot be considered expenditure - dividend representing part of the net profits of the activity, as well as the receiving capital which cannot be considered income as capital is the base of the entity's activity.

The fundamental difference between these two models, as was pointed by H.A. Finney and Herbert E. Miller, it is a matter of time. It is eloquent the process of associating the revenues with expenses that have been generated to obtain incomes, as an association, a matching process. This process of association it is accomplished by the accrual basis, not being accomplished by cash basis, unless revenues are earned in the same period in which the cash is received and the expenses are incurred in the same period in which the cash payment is made. (Finney H.A. and Herbert E. Miller, 1963, p. 62)

In the article "General regulation for the preparation and presentation of financial statements and the convention of the accrual accounting" published in the national Courier 13.01.2011 Raileanu Adriana Sofia (2011), compares the concept of accrual accounting to the cash accounting.

Elements in this matter are presented also by Berheci M in his "Recovery of financial statements" (2010, pag. 194). Based on this, a comparison of the two models of accounting is presented in the table. No.1.

Table no. 1.

Comparative Presentation of the two accounting models	
Accrual basis	Cash basis
- accounting of incomes and expenses independently of movements of cash	- accounting of income and expenses only when a receipt or a payment is made
- any basic generation of revenue and expenditure it is recorded in accounting	- the lack of cash movements attract a lack of accounting records
- expenses and income are grouped as being exploitative, financial and extraordinary	- it is made a distinction between operational activities, funding and investment
- annual financial statements are prepared in an exhaustive manner through a sequence of logical steps in accordance with the legal provisions	- it is needed the restatements for the purpose of preparation of the financial statements
- provides information also about receipts and payments of cash and cash equivalents	- provide information only to receipts and payments of cash and cash equivalents
- provides users with information on profit	- allows users appreciation of quality by determining the difference between the net profit and net cash

Source: Authors' contribution after Raileanu A.S. (2011), and M. Berheci (2010)

SWOT analysis for "cash accounting" and "accrual accounting" methods

Kieso and Weygandt (1998, p. 105), trying to find the weaknesses of the accounting model "cash," notes that this method is very useful and relevant to the professions such as doctors, lawyers, architects or even for entities providing services in advertising. I mean, for those areas where the generation of income coincide with receiving the payment and the moment of payment coincide with making the expenditure. They believe, and rightly so, that for many users, information on receipts and payments is something solid, concrete. Therefore, the remark is clear address to the transmitted by the accounting model "cash".

The same authors appeal to the American expression: "cash is oil that lubricates the economy". If so, it means that it is more useful the accounting model "cash". What, then, is the merit of "accrual" model?

Starting from those cited, Weygandt and Kieso, and analyzing the current economic context, we believe that today's economy lubricant is the credit rather than cash. Accrual basis and not the cash basis recognize all phenomena related to credit. Receivables and payables are forecasts of future inputs and outputs of cash. In other words, the advantage of using the accrual basis is visible in the estimation of future cash flows through the reporting of transactions and other events at the moment when they occur. If you were to do SWOT analysis of two accounting models, some of the strengths and weaknesses of these would be those presented in Figure no. 2.

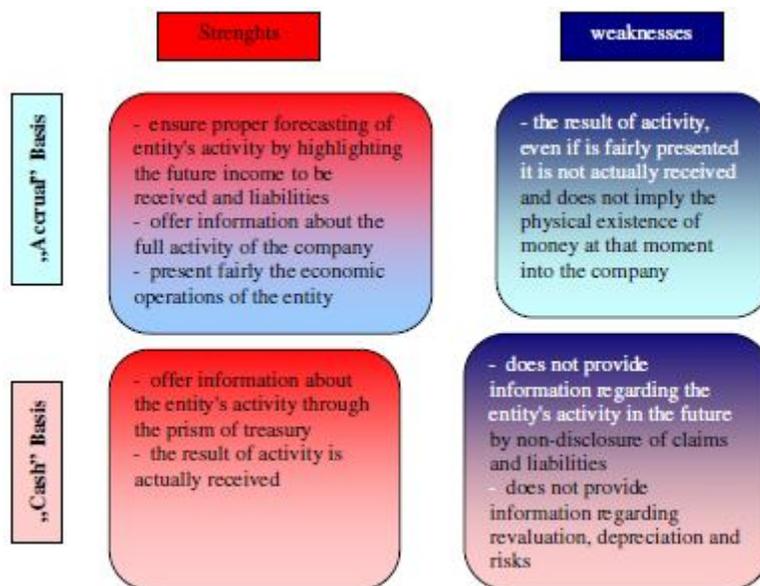


Figure no. 2. SWOT analysis of accounting models

Source: Authors' contribution

Non-recognition of liabilities, where the cash basis is use, in some situations, not only has the disadvantage that there are not presented information regarding future cash outflows, but regarding loans or credits are not given any information about any expenses arising from such loans.

Cannot be neglected neither the aspects concerning the evaluation of the assets of an entity, considering that during their existence, they can suffer changes in fair value, changes in the form of depreciation or appreciation of assessments. These appreciations occur when it comes to reevaluation of assets owned and there is recognized possible depreciation in the form of adjustments for depreciation or amortization. All of these are recognized using the accrual basis.

Accrual basis method is more complete than cash basis method as it helps to identify an efficient use of resources, provides comprehensive information on the assets and liabilities by portraying a true image of the financial statements, which allows a better management for decision-making. In a same time it is needed to make known the fact that accrual basis presents a range of efforts, from which may be mentioned the preparation and training of qualified personnel, as well as periodic review of procedures and accounting policies transforming accounting "from a tool for counting values in a tool that reflect reality, with the help of the following key elements of accrual accounting method: depreciation/amortization of fixed assets, revaluation of fixed assets, the provisions, and also accrual accounting of payables and receivables. "(Bolos M.I., Florea E. and Trifan V., 2011)

One of the obvious and immediate advantages of application of accrual basis consists in preparation of comprehensive and transparent financial reporting. It means to obtain a result of the reported period that is an economic result that expresses the actual performance of the entity at the end of the period, taking into account the totality of the revenues (regardless of whether they were paid or not) as well as all expenditure incurred (whether paid or not) in the current financial year.

Cash basis is a source of useful information just on the short term, in the period reported, without providing information about the entity's commitments in the past or the future. Current information are useful, but do not have information on the entity's debts of the more or less distant future, the manager, the managerial team cannot take reliable decisions for entity.

Conclusions and Proposals

Indeed, each model presented has both positive aspects and unfavorable aspects, in this study were identified only a few aspects more common in the activity of an entity. The accounting information provided by the accounting model applied must serve the user and its target or its purpose. Cash activity of an entity is important in every moment of its existence. Cash basis method provides information on the activity of the present time, while accrual basis model provides information regarding future receipts and payments by present recognition of receivables and payables.

Accrual basis provides benefits stemming from the possession of the accounting information about the amounts collected in terms of a more transparent and systematic knowledge about the receivable and payables in the sense of commitment, and also the sums actually disbursed.

Cash basis is useful and presents sufficient information in small entities, in which economic activity is organized in such a way that the moment of recognition of income and receiving it are the same, and the moment of making expenses coincide with the time of payment. That is, in the modern economy, the case of income from independent activities carried out on the basis of the liberal professions and small craftsmen. For them, the determination of the result of their activity, it is one based on cash flow and the profit realized is one actually received.

We must, however, mention that currently in Romania, those who use the cash basis and realize income from independent activity, must register, in addition to The Journal of Receipts and Payments, a record of the assets owned and inventoried annually, records kept using The Inventory Journal.

The accrual basis provides information about present and future cash of an entity with the developed and diversified economic activity, for which the accounting recognition of revenues and expenses, assets, liabilities and capital shall be in accordance with the rules of accounting recognition set by the applicable financial reporting regulation. This model is a much better base in taking decisions about future activity and regarding the use of the resources held by the entity. It is not neglected any cash flow, the entities preparing in annual financial reports the Statement of cash flows.

Comparing these two accounting models, "cash accounting" and "accrual accounting", we found importance of each model to account for the presentation of financial information.

In further research we want to analyze how they may or may not have fiscal influence for economic entities, and influence models of accounting in managerial decision making.

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