

Accounting

Finance



**ASSIGN
BUSTER**

Week Six Application: Bases of Accounting. Perform the following: The ___b. Accrual _ basis of accounting recognizes income when it is earned and expenditures when they are incurred.

- a. Primary
- b. Accrual
- c. Checkbook
- d. Cash

Briefly explain which basis of accounting and the reasons why that basis of accounting is not desirable for most organizations.

As opposed to accrual method, cash basis of accounting is the one that is not desirable for most organizations, because it does not match income to expenses which produces the income. Cash basis of accounting only recognizes income when cash is received, and expenses when cash is disbursed. Generally accepted accounting principles (GAAP) follow the accrual basis of accounting as a sound method of reporting income, since it matches income with the relevant costs that produced that income. (Larson & Jensen, 2010)

If an organization uses the cash basis method, there is a danger of having misleading information about the long-term profitability of the firm.

(Fishman) For example, if a firm has an unusual cash collection for a particular month, it might be construed as the firm performing exceptionally well on that month. The truth is, there could have been a very low volume of sale for the period, but credit customers sent their payments in, thus the unusually high volume of cash receipts for the month. If the firm had used the accrual basis of accounting, it would have immediately showed on its

financial statements the low sales for the period, because it only recognizes revenues when products or services are rendered to customers. For planning purposes, it is therefore not desirable for most organizations to have the cash basis, as it does not give the complete picture of the operations of the company.

Bibliography

Fishman, S. (n. d.). Cash vs. Accrual Accounting. Retrieved from [www.nolo.com](http://www.nolo.com/legal-encyclopedia/cash-vs-accrual-accounting-29513.html): <http://www.nolo.com/legal-encyclopedia/cash-vs-accrual-accounting-29513.html>

Larson, K., & Jensen, t. (2010). *Fundamental Accounting Principles*. U. S. A.: McGraw-Hill Ryerson.