Cash vs. Accural Accounting

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Cash Accounting – tracking profit based on cash on hand. Using this method, revenue is equal to how much cash customers gave the business this period, less how much cash the business paid out that period. Using this method of accounting is simple, but also leaves room for companies to misrepresent their financial health. Basically – Judging how profitable a business is based on how much cash they have in the bank.

Accrual Accounting – the method of accounting SedonaOffice is based on, and the method required by accounting governing bodies for large companies. This method requires companies to report their revenue based on how much money they *earned*, not how much cash they were given. They must also report expenses based on what expenses they *incurred*, not what cash actually went to bills. This paints a more accurate picture of a company's financial health. Basically – judging how profitable a business is based on how much revenue they earned compared to the total expenses they incurred.

Example of Cash vs. Accrual Accounting Reporting – In January, a company decides to bill their customer early for work they plan to do in February, they create one 100 invoice for January, and a second 100 invoice for February. Their customer pays the full 200 when they receive the invoices in January. Based on cash accounting, the company would recognize 200 in revenue for January, and 0 in revenue for February, because cash accounting only cares about the amount of cash you give out and receive, and the full 200 was received in January. This doesn't do a good job of capturing what really happened. The company wasn't very profitable in January and then not profitable at all in February, they just happened to bill early. They were equally profitable in both months.

Accrual accounting solves this problem. Based on accrual accounting the company would recognize 100 in revenue for January, and 100 in revenue for February, because that is when they performed the service and earned that revenue. This gives us a more accurate picture of how profitable the business was in January and February.