

Chapter – 4 Bases of Accounting

There are two bases of ascertaining profit or loss, namely:

(1) Cash Basis, and (2) Accrual Basis

1. **Cash Basis of Accounting:** Under this system of accounting, transactions are recorded in the books of accounts only on the receipt/ payment of cash. The income is calculated as the excess of actual cash receipts (in respect of sale of goods, services, properties etc.) over actual cash payments (regarding purchase of goods, expenses, rent, electricity, salaries etc.). Entry is not recorded when a payment or receipt is merely due i.e., outstanding expenses, accrued incomes are not treated. This method is contradictory to the matching principle.

2. **Accrual Basis of Accounting:** Under this system of accounting, revenue and expenses are recorded when they are recognized i.e., income is recorded as income when it is accrued (when transaction takes place) irrespective of the fact whether cash is received or not. Similarly, expenses are recorded when they are incurred or become due and not when the cash is paid for them. Under this system, expenses such as outstanding expenses, prepaid expenses, accrued income and income received in advance are identified and taken into account. Under the Companies (amendments) Act 2013, all companies are required to maintain their accounts according to accrual basis of accounting.

Difference between accrual basis of accounting and cash basis of accounting Basis

Basis	Accrual Basis of Accounting	Cash Basis of Accounting
1 Recording of transactions	Both cash and credit transactions are recorded.	Only cash transactions are recorded.
2 Profit or Loss	Profit or Loss is ascertained correctly due to complete record of transactions.	Correct profit/loss is not ascertained because it records only cash transactions.
3 Distinction between Capital and Revenue items	This method makes a distinction between capital and revenue items.	This method does not make a distinction between capital and revenue items.
4 Legal position	This basis is recognized under the companies Act, 2013.	This basis is not recognized under the companies Act, 2013.
5 Prepaid/ Outstanding Expenses; Accrued Income / Income received in Advance	Prepaid & Outstanding expenses are accounted in the Profit & loss A/c. Accrued income & income received in advance are also accounted and shown in the Balance Sheet.	Prepaid & outstanding expenses are not adjusted. Similarly, accrued income & income received in advance are not adjusted
6. Technical Knowledge	The Accrual Basis of Accounting require technical knowledge as many adjustment like prepaid, outstanding, capital & revenue are required to be made	It does not require much of technical knowledge as is required for Accrual Basis of Accounting.
7. Acceptability	Accrual basis of Accounting is more acceptable in business as it reveals correct income and expenses besides assets and liabilities.	Cash basis of accounting is not acceptable in business as it does not reveal the required information.