

Cash-Basis vs. GAAP Accrual-Basis Accounting (& Tax Returns)

Cash-Basis Accounting is not allowed for Govt contractors, they must do GAAP Accrual-Basis Accounting. Following explains how Cash-Basis differs from Accrual-Basis Accounting with summary example entries. Red = Cash entries, Blue = Accrual entries (temporary account that clear to zero), Black = Perm entries.

CASH-BASIS ACCOUNTING

Cash-basis accounting records transactions when the cash changes hands, such as when cash is received from a customer or paid to a vendor. Cash received increases the cash and cash paid out decreases cash. Cash-basis entries are determined depending on whether the cash came in or goes out of cash accounts.

Payroll Payment

DR Increase Labor Cost
CR Decrease Cash Account

Vendor Payment

DR Increase Non-labor
CR Decrease Cash Account

Customer Receipt

DR Increase Cash Account
CR Increase Revenue Account

ACCRUAL-BASIS ACCOUNTING

Accrual-basis accounting records costs in the month they are incurred, for example, timesheets for the period ending 3/31/15 would be recorded with date of 3/31/15 to be included in March financials. Payroll is typically run a few days later, using those same labor amounts to pay the employees and taxes.

3/31 Timesheet Entries

- 1) DR Increase Labor Expense
CR Increase Payroll Payable

3/31 Payroll Tax Accrual

- DR Increase PR Tax Expense
CR Increase PR Tax Payable

4/10 Payroll/Tax Payment

- DR Decrease Payroll Payable
DR Decrease PR Tax Payable
CR Decrease Cash Account

3/31 Expense Reports

- 2) DR Increase Non-labor Cost
CR Increase Exp Rpts Payable

3/31 AP Vendor Entries

- DR Increase Non-labor Cost
CR Increase Accounts Payable

4/30 AP Vendor Payment

- DR Decrease Accts Payable
CR Decrease Cash Account

3/31 Revenue Entries

- 3) CR Increase Revenue
DR Increase AR Unbilled

4/5 AR Billing Entries

- DR Increase AR Billed
CR Decrease AR Unbilled

5/5 Customer Paid

- DR Increase Cash Account
CR Decrease AR Billed

Accrual-basis records cost in the month incurred to match related revenue booked in the month earned. For example, labor & non-labor cost (from timesheets & vendor invoices) for the period ending 3/31/15 to match with revenue recorded in March, which is the month it was earned in and will be billed in April.

Note the accounts in blue are accrual accounts that zero out with the posting of cash transactions to accommodate the GAAP Principle of "Matching" revenue to related labor and non-labor cost incurred. Basic GAAP (Generally Accepted Accounting Principles) compliance is prerequisite for DCAA compliance.

INCOME TAX RETURNS

Income taxes are computed separately from accounting, on cash or accrual basis, per IRS regulations or company choice if no limitations. There will almost always be differences between books and tax returns but doing both on the same basis results in fewer differences to be reconciled between books and taxes.