

TOPIC 1.1: UNDERSTANDING THE DIFFERENCE BETWEEN CASH AND ACCRUAL ACCOUNTING

The objective of financial statements is to provide information about the financial position, financial performance, cash flows, and changes in net assets (i.e. community wealth) of the municipality in a manner that is useful to a range of users.

To best meet these objectives, financial statements should be prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not when cash or its equivalent is received or paid i.e. the cash basis), and they are recorded in the accounting records and reported in the financial statements of the period to which they relate.

Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash, but also of obligations to pay cash and/or potential to deliver services in the future. Thus they provide the type of information that is most useful to users to assess the responsibility for stewardship and accountability of government.

If, for example, the municipality bills its consumers for services rendered before 30 June (end of financial year), the recoverable portion of debtors billing is recorded in the accounting records as revenue even though the payment of accounts may only take place in the new financial year (after 1 July). Similarly, if an entity prepares its June payroll on 25 June, all the expenses associated with this payroll will be recorded as employee-related costs during June even though the portion of those costs which relates to PAYE or pension and medical aid contributions is only paid over during July. This is due to the fact that in an accrual system expenditure is recorded when incurred.

The full accrual basis of accounting is the generally recognised basis of accounting for entities. It places emphasis on earnings as a measure of efforts rather than on the inflows and outflows of any type of resources.

When revenue and expenses cannot be accurately measured at the end of the accounting period, for example services rendered by resources acquired through property rates, electricity meters read at a date other than the end of the period, or goods received but not yet invoiced or paid, the accrual basis is applied in the sense that revenue must be measurable and available within the accounting period or soon enough thereafter to pay for liabilities incurred during that period. Likewise, expenses for operations and capital assets are recognised when such liabilities are incurred, if measurable.

The following table serves as a summary of some of the differences between the cash and accrual basis of accounting:

ACCOUNTING ITEM	CASH BASIS OF ACCOUNTING	ACCRUAL BASIS OF ACCOUNTING
Short and long term liabilities	Liabilities not recognised.	All liabilities accounted for where present obligation exists due to past event for which settlement requires outflow of economic benefits
Leases	All transactions in terms of leasing arrangements are expensed when paid.	Leasing arrangements are categorised as finance or operating leases and assets held under finance leases are recognised in the AFS.
Non-current and current provisions	Provisions are not recognised.	All provisions accounted for where liabilities exist of uncertain timing or amount
Debtors and creditors	Debtors and creditors are not raised. Revenue and expenses are recorded when cash is received or paid	Debtors and creditors are raised in order to account for revenue and expenditure when it accrues to the entity
Property, plant and equipment	Property, plant and equipment are expensed when acquired	Property, plant and equipment are capitalised/recognised as assets when acquired
Investment property	No distinction is made between investment property and property, plant and equipment.	Distinction is made between investment property and property, plant and equipment.
Inventories	Inventories are expensed when acquired, e.g. government departments expense all inventories acquired	Inventories are capitalised as current assets when acquired, and expensed when consumed.
Service revenue	Service revenue is recognised when cash is received for services rendered or to be rendered in the future (e.g. advances received).	Service revenue is recognised in the financial year when services have been rendered (i.e. when the revenue is earned).
Sale of goods	Revenue is recognised for the sale of goods when cash is received.	Revenue is recognised for the sale of goods when the entity has transferred to the buyer the risks and rewards of ownership and when the entity no longer controls the goods

ACCOUNTING ITEM	CASH BASIS OF ACCOUNTING	ACCRUAL BASIS OF ACCOUNTING
Government grant and subsidy revenue – conditional grants	Revenue is recognised when government grants and subsidies are received, even if the grants are conditional.	Revenue is recognised for government grants and subsidies received when the conditions (if any) are met.
Interest	Interest received or paid in cash is recognised.	Interest is recognised once it accrues.
Accrual of expenses and revenue for incomplete billing periods	Revenue for services rendered or sale of goods and expenditure for purchases or services received are recognised when the related cash is received or paid	Revenue is recognised when services are rendered and goods are sold and expenses are recognised when goods or services are received, taking into account the accruals for revenue and expenditure for the last few days of the financial year for which billing takes place after year end