

Unlocking the Mysteries of Accrual Accounting



How does accrual accounting differ from cash basis accounting?



The Main Difference

The main difference between accrual and cash basis accounting lies in the timing of when revenue and expenses are recognized.



The Cash Method

- Under the cash method, revenue is reported on the income statement only when cash is received.
- Expenses are only recorded when cash is paid out.
- This method is not the norm in governmental accounting because it could be used to manipulate the “bottom line”, either by:
 - A) Accelerating cash receipts and/or slowing down cash disbursements so as to increase the bottom line, or
 - B) Slowing down cash receipts and/or accelerating cash disbursements so as to decrease the bottom line.

The Accrual Method

- Under the accrual method, revenue is accounted for when it is earned, whether or not cash has yet changed hands.
- Similarly, expenses are accounted for once an obligation to pay for goods or services received has been incurred, whether or not cash has yet changed hands.

An Example of Accrued Revenue

- Say that on June 30, 2018, one of your federal accounts incurs \$100,000 in expenditures eligible for reimbursement, causing the yearend balance in the account to be (\$100,000).
- Now say that, for whatever reason, you won't be drawing the money down until sometime in FY19, even though it has technically been "earned" in FY18.
- The fact that the account shows a \$100,000 negative balance as of June 30, 2018 will cause the Office of Accounts and Control to debit an account receivable and credit an accrued revenue in this amount in FY18, since this tells us that there was money due but not yet received in FY18.

But What Happens When the Cash Actually Comes In Sometime In FY19?

- You'll create a journal entry to debit cash and credit revenue in FY19, as usual.



But Won't the Revenue Then Be Counted Twice, Once in FY18 and Again in FY19?

- Yes, that's exactly right, UNLESS.....



Accrual Reversal in New Year

- The Office of Accounts and Control creates a journal entry in the new year that reverses the journal entry that it booked in the old year!
- The net effect will be:
- Revenue of \$100,000 is booked in the old year, when it was actually earned.
- Revenue of \$100,000 is also booked in the new year, but it's offset by the accrual reversal in the new year, so that in total, none of the revenue is booked in the new year.
- The FY18 account receivable that was carried into FY19 because it was a balance sheet item will be netted out as well. There is no longer a receivable in FY19 since the money was actually received in FY19.

MISSION ACCOMPLISHED!!!!



An Example of Accrued Expense

- The theory behind booking accrued expenses is merely the flip side of what was just discussed in terms of accrued revenue.
- Say that in July, 2018, you receive a bill from a vendor for goods received on or before June 30, 2018, and that it's too late to submit it to the Accounts Payable section to be paid in FY18.
- If this bill is for \$250,000 or more, backup for it should be submitted to the dedicated Outlook mailbox address Yearend.Payables@doa.ri.gov by the deadline given in the fiscal closing timetable.

An Example of Accrued Expense (cont'd)

- The Office of Accounts and Control will then debit an accrued expense for the amount of the bill (say, \$300,000), and credit an account payable in this amount.

So How and When Will the Bill Actually be Paid?

- In addition to submitting backup for the bill to the dedicated Outlook mailbox described above, you should also submit the bill to the Accounts Payable section of the Office of Accounts and Control the same way you do at other times of the fiscal year. This will cause it to be booked as an expenditure and be paid in FY19.

But Won't the Expenditure Then Be Counted Twice, Once in FY18 and Again in FY19?

- Right again! UNLESS, of course.....



Accrual Reversal in New Year

- The Office of Accounts and Control creates a journal entry in the new year that reverses the journal entry that it booked in the old year!
- The net effect will be:
- Expenditures of \$300,000 are booked in the old year, when they were actually incurred.
- Expenditures of \$300,000 are also booked in the new year, but they're offset by the accrual reversal in the new year, so that in total, none of the expenditures are booked in the new year.
- The FY18 account payable that was carried into FY19 because it was a balance sheet item will be netted out as well. There is no longer a payable in FY19 since the money was actually disbursed to the vendor in FY19.

MISSION ACCOMPLISHED!!!!

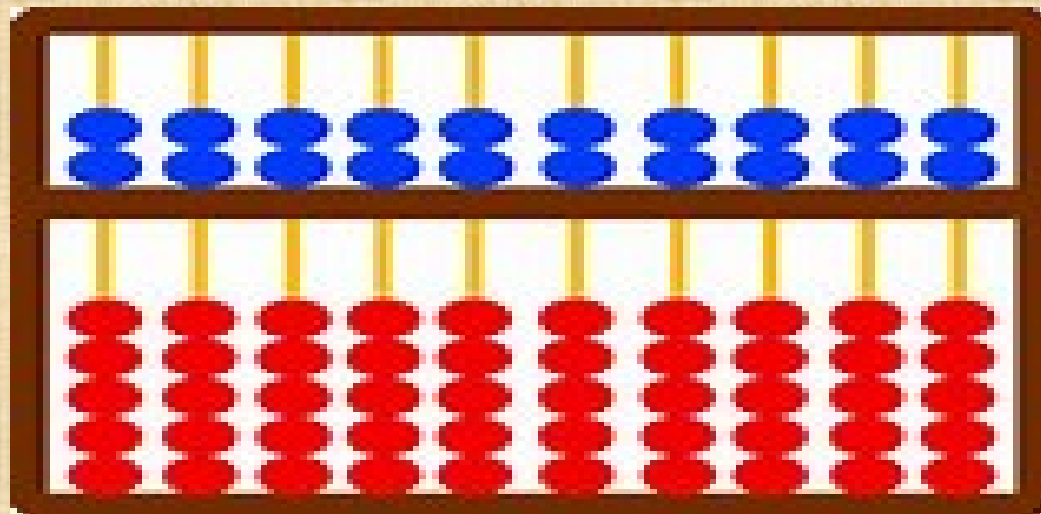


And Finally, an Example of an Accrued Payroll Expense

- Say that the first payday of FY19 is on July 13.
- It is designed to pay the employees for the ten days worked from June 25, 2018 through July 6, 2018.
- The first five of these workdays happen to fall within FY18, and the last five fall within FY19.
- To ensure that payroll expense is allocated properly between the two fiscal years, we somehow have to allocate 50% of the July 13 payroll to FY18 and the other 50% to FY19.

And Finally, an Example of an Accrued Payroll Expense (cont'd)

- The State will approximate the amount to charge back to FY18 by accruing 50% of the amount of the payroll paid on June 29, 2018 as an additional partial payroll chargeable to FY18.



Let Me Guess – Will There Be an Accrual Reversal in FY19 So That Payroll Expenses in FY19 Are Not Overstated?

- Yes, the Office of Accounts and Control will reverse in FY19 the payroll accrual that will have been made in FY18.
- This will ensure that only 50% (approximately) of the first payroll paid in FY19 will actually be charged to FY19.
- Go to the head of the class!



A Special Appeal

- As a general rule, State agencies should not take it upon themselves to create accrual or reverse accrual entries.
- The Office of Accounts and Control will create the appropriate accrual entries on your behalf whenever you submit accounts receivable or accounts payable information to our dedicated Outlook mailboxes by the deadline dates.
- We will also book accrued revenues or deferred revenues depending on the ending balances we see in your federal accounts.
- We coordinate closely with the Department of Revenue to accrue those tax and other revenues for which it is responsible.
- The Office of Accounts and Control also handles all yearend payroll and fringe benefit accruals.
- The Office of Accounts and Control automatically reverses in the new fiscal year all accruals that are posted to the old fiscal year.

Questions

- Feel free to contact anyone in the Accounting and Reporting Section of the Office of Accounts and Control if you have any questions concerning specific accrual entries.

