

# The Pros and Cons of Accrual Accounting for Your Business

8 min read



It's not uncommon for business owners to be unaware of the different methods of accounting (and how they can actually serve your business in different ways). After all, you didn't start your business to have your hands dirty in the back office.

## Key Takeaways

- **What Is Accrual Accounting?** Also called accrual basis accounting, the accrual accounting method requires that transactions be recorded at the time they occur in agreement – not at the time when cash is actually received or spent.
- **The Pros and Cons of Accrual Accounting:** Whether you're required to use it or not, accrual basis accounting offers both benefits and drawbacks, and it's important to be aware of both to ensure you make the most of this potentially powerful accounting method while simultaneously shielding your business from any issues that could potentially arise.
- **Reap the Benefits of Accrual Accounting With These Accrual Accounting Best Practices:** Following these best practices for accrual accounting can help you take advantage of this advanced and preferable method of accounting.

Let's take Accrual Accounting (or Accrual Basis Accounting) for example.

Depending on the size of your organization, and whether it is privately owned or publicly traded, the accrual accounting method might be required by the Generally Accepted Accounting Principles (GAAP).

However, if you are just starting out, are not publicly traded, or have a smaller-medium business, then it is up to you to decide which accounting method will work best for you.

Along with cash accounting, the accrual accounting method is one of the most popular. However, it has both advantages and disadvantages, and the method that's truly right for your business will depend on your company's needs, financial health, and business type.

## What Is Accrual Accounting?

Also called accrual basis accounting, the accrual accounting method requires that transactions be recorded at the time they occur in agreement – not at the time when cash is actually received or spent. <sup>[1]</sup>

So, for example, if a contracting company with a government contract were using the accrual accounting method, the company would record their payment upon completion of the project, even though the government agency would likely still need to approve the job before actually remitting payment.

With the accrual accounting method, the contracting company would record the income from the contract weeks or months before they actually collect the payment. Likewise, if the government agency is also using accrual basis accounting, then they would also record the payment upon completion of the project, even though a check had not yet been sent.

## The Pros and Cons of Accrual Accounting

Whether you're required to use it or not, the accrual basis accounting offers both benefits and drawbacks, and it's important to be aware of both to ensure you make the most of this potentially powerful accounting method while simultaneously shielding your business from any issues that could potentially arise.

### The Advantages of Accrual Accounting

#### 1. It's Compliant With GAAP

Even if you are not yet required to use the accrual accounting method, one solid argument for establishing this practice in your business now is that it is the method required by the GAAP.

As your company grows, you might eventually be required to switch over to accrual accounting in the future, so already having this method in place and being accustomed to using it will put you at a significant advantage down the road.

**Read More:** [What the Generally Accepted Accounting Principles \(GAAP\) Mean to Your Business](#)

## 2. It's More Transparent

Unlike the cash accounting method which only shows transactions as they happen – not as they're about to happen – accrual accounting is much more transparent because it shows a business's accounts as they are about to be or truly are, reflecting all of the money that will soon be coming in and all the payments that will soon be going out.

As a result, the accrual accounting method provides business leaders with a much clearer picture of a company's financial health at any given time.

## 3. It Simplifies Strategic Planning

Since accrual accounting reflects certain future cash flow activities, it enables much better strategic planning.

With this accounting method, business owners can quickly identify when a cash flow shortage might be on the horizon or when a cash influx is coming. As a result, accrual accounting allows you to better plan ahead to prevent crises as a result of unforeseen shortages and to be prepared to make the most of upcoming windfalls.

## The Disadvantages of Accrual Accounting

### 1. It Can Be Challenging

Cash accounting is straightforward: record expenses as they go out and record income as it comes in. Accrual accounting, on the other hand, is not so straightforward. There are several rules that need to be followed and a consistent process must be established for defining when and how to record certain types of expenses and income. Additionally, tax forms can be slightly more complicated to complete when using the accrual accounting method.<sup>[2]</sup>

Much of these rules and procedures are outlined by the Generally Accepted Accounting Principles. However, it can be complicated to understand, follow, and implement in your own business. The help of a professional accountant can ensure you're maintaining the proper standards for your business type, size, and industry.

### 2. It Can Be Difficult to Switch to Accrual

If you are already using a different accounting method in your business, switching over to the accrual method can be challenging. For example, having cash flow issues can exacerbate this

challenge. That being said, cash flow improvement and transparency are important reasons why businesses should use the accrual method.

### 3. It Can Leave You Vulnerable to Fraud

If you are handling your business's finances on your own or with a few back-office employees, the accrual accounting method can open your business up to the potential for fraud. To safeguard your company from internal fraud and to ensure your financial statements are always accurate, it's essential to have proper systems of control in place – especially, if you do not feel fully comfortable evaluating the company's ledgers and understanding the accrual accounting method.

Tip: Outsourcing accounting is one of the easiest ways to outsmart fraud, by also providing an immediate separation of accounting duties. The most important best practice to prevent fraud follows the standard accounting practice of separation of duties!

**Read More:** [Cost Analysis: Outsourcing vs. In-House Accounting for Your Business](#)

## Reap the Benefits of Accrual Accounting With These Accrual Accounting Best Practices

Accrual accounting can be a challenge to implement and maintain. However, its benefits are well worth the extra effort. Following these best practices for accrual accounting can help you take advantage of this advanced and preferable method of accounting.

### Determine If It's Right for Your Company

For some small businesses that are not required to use accrual accounting for compliance purposes, sticking to the cash accounting method will simply make more sense.

Sometimes, this includes companies that operate with simple cash transactions and have no inventory to account for. That being said, every industry and business is unique, and the accounting method that's best for your company truly depends on its unique needs, interests, requirements, and goals.

### Prepare a Budget, Use It, and Revise It

Attempting to use the accrual accounting method without a budget will leave you operating in the dark.

You need a forecast and plan against which you can check your record of actual expenses and income throughout the year. Otherwise, operating from a cash-on-hand perspective, it'll be difficult to tell what money you're actually spending and if you truly have it to spend.

## Regularly Review Accounts Payable and Accounts Receivable

Make sure your current finance function is keeping close tabs on your payables and receivables – especially, the receivables. If your company has aging receivable accounts that have no response to communications, you might need to think about writing them off as losses and removing them from your income.

**Read More:** [Your Bottom Line Is Taking The Hit. Is It Poorly Managed Accounts Payable?](#)

## Use Dual Control and Separate Powers

To protect your company from the potential for internal fraud when using the accrual accounting method, you should separate powers within your bookkeeping department. For example, the individual writing checks should not be the person reconciling your bank statements.

Small Businesses are the most vulnerable to fraud! \$200,000 is the median loss of annual revenue reported per small business fraud cases.<sup>[3]</sup>

## Document Your Processes and Procedures

Finally, consistency is the key to successfully using the accrual accounting method. One way to ensure consistency is to document all of your policies and procedures for recording expenses and income, budgeting, reconciliation, collections, and every other task that's required to successfully execute your accounting system.

# Simplified and Secured Accrual Accounting With Outsourced Bookkeeping, Accounting, and Controller Services

If you do decide to use the accrual accounting method in your business, you will benefit greatly from the financial insights and clarity it provides. To establish this accounting method in your business or for ongoing assistance with its execution, it is often advisable to seek professional assistance.

While hiring full-time bookkeeping and accounting professionals as employees in your company can be quite costly, small and medium-sized businesses do still have the option of taking advantage of outsourced accounting services. With outsourcing, you can get professional advice regarding the best accounting system for your business in addition to setting up an accrual accounting system, implementing tools and technology to streamline and automate the process, and implementing controls to safeguard your business finances from fraud.



# Are You Measuring How Your People Drive Profit?

A guide to help you interpret Company & People KPIs so you can increase profit!

**DOWNLOAD NOW**

[1] <https://www.investopedia.com/terms/a/accrualaccounting.asp>

[2] <https://www.investopedia.com/ask/answers/09/accrual-accounting.asp#:~:text=The%20disadvantage%20of%20the%20accrual,profitable%20in%20the%20long%20term.>

[3] <https://business.fau.edu/centers/center-for-forensic-accounting/public-resources-on-fraud/fraud-in-businesses-and-non-profits/small-businesses-fraud/#:~:text=According%20to%20a%20survey%20by,median%20loss%20of%20only%20%24104%2C000>