

Accrual Accounting

Statement of financial position accounts are **permanent** account in that **their balances carry over from one fiscal year to the next.**

Income statement accounts are **temporary** because they get **reset to zero at the beginning of each fiscal year.**

Cash vs. Accrual Accounting

Cash basis of accounting

Revenues and expenses are recorded only when cash is received or paid.

Accrual basis of accounting

Revenues are recognized when earned (regardless of when the cash is received) and expenses are recognized when incurred (regardless of when the case is paid).

Adjusting Entries (Summary)

	PREPAYMENTS	ACCRUALS
	Cash is paid or received before the event.	Event has occurred, but the cash has not yet been paid or received.
EXPENSES	Prepaid expenses: Dr. Asses / Cr. Cash	Accrued Expenses: Dr. Expense or Asset / Cr. Accounts Payable
REVENUES	Unearned Revenues: Dr. Cash / Cr. Liabilities	Accrued Revenues: Dr. Accounts Receivable / Cr. Revenues

Prepaid Expenses

Costs are initially recorded as assets an allocated to expenses of future periods. Examples include:

- Prepaid rent and insurance,
- Office supplies,
- Plant and equipment.

Unearned Revenues

This is cash received in advance of service provided. The unearned revenues are classified as liabilities until the service is rendered. Examples include:

- Rent collected in advance
- Subscriptions collected in advance
- Gift certificates
- Deposits on special orders

Accrued Liabilities

These are expenses incurred in the current period, but for which payment will occur in future periods. There is no cash flow on recording, only when paid. Examples include:

- Payroll,
- Income taxes,
- Interest,
- Electricity.

Accrued Asset

Record revenue and corresponding receivable in period earned, receive payment in the future. Examples include:

- Credit sales,
- Rent revenue,
- Interest receivable

Closing Accounts

All expense and revenue accounts are temporary accounts (at the end of the year they get reset to zero). Offsetting amount is net income and gets recorded to retained earnings.

Dividends are normally debited directly against the retained earnings account.