

5.6 | Accruals concept

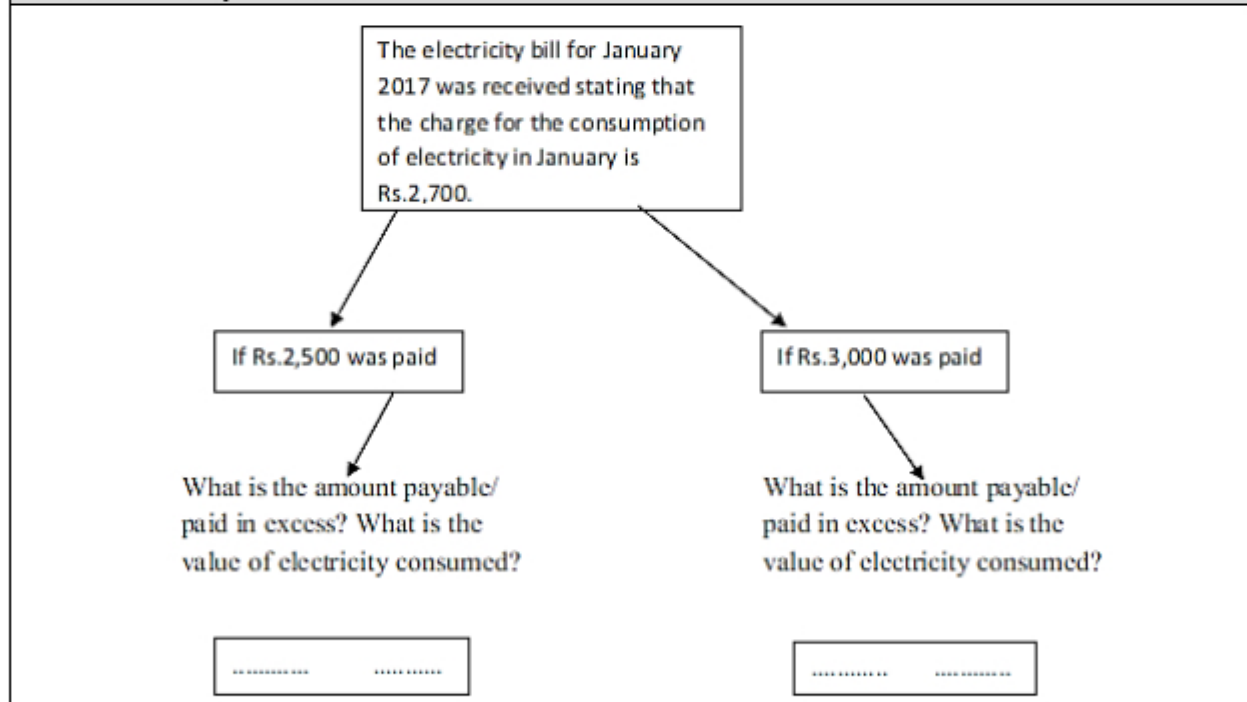
- Accruals concept
- Application of the concept in preparing financial statements

Accruals concept

- When preparing accounts for a specific period, all income relevant to that period (whether received or not) are accounted for as income, and all expenses incurred during that period (whether paid or not) must be recognized as expenses.
- The accruals concept is important in being able to reveal accurately the financial results for the period.

Instances when the accruals concept is applied

- Accrued expenses / Payable expenses
- Prepaid expenses / Payments in advance
- Accrued income / Income receivable
- Pre-received income / Income received in advance
- Debtors
- Creditors

Accruals concept in action

Accruals concept double entries

| | | Debit | Credit |
|---|--------------------------------|-------|--------|
| 1 | Relevant expense a/c | x | |
| | Relevant payables a/c | | x |
| 2 | Prepaid expense a/c | x | |
| | Relevant expense account | | x |
| 3 | Income receivable a/c | x | |
| | Relevant receivables a/c | | x |
| 4 | Relevant income a/c | x | |
| | Income received in advance a/c | | x |

Accrued expenses

- Expenses that have been incurred during the period, but have not been paid for as at the last day of the period are known as accrued expenses (this is a liability to the business).
- When accounting for the operating results, the accrued expenses must be adjusted.
- Relevant adjusting entry:

| | |
|--------------------------|--------|
| Relevant expense account | Debit |
| Accrued expenses account | Credit |

Prepayments / Payments in advance

- Payments made for a period that extends beyond the current accounting period (this is an asset to the business).
- Relevant adjusting entry:

| | |
|----------------------|--------|
| Prepaid expenses a/c | Debit |
| Relevant expense a/c | Credit |

Income receivable

- Income relevant to the period but not received as at the last date of the period is known as income receivable (this is an asset to the business).
- Relevant adjusting entry:

| | |
|-----------------------|--------|
| Income Receivable a/c | Debit |
| Relevant income a/c | Credit |

Income received in advance

- Income received in excess of the amount due for the accounting year is known as income received in advance (this is a liability to the business).
- Relevant adjusting entry:

| | | |
|--------------------------------|-------|--------|
| Relevant income a/c | debit | |
| Income received in advance a/c | | credit |

Debtors and creditors

- When transactions are recorded under the accruals concept, it results in creating debtors and creditors (these are inputs relevant to the accruals concept).

| | | |
|----------------------------|---|-------------------------------|
| Income receivable | } | These are current assets |
| Prepaid expenses | | |
| Accrued expenses | } | These are current liabilities |
| Income received in advance | | |

