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ACCRUAL BASIS

Accounting

Defination:

Accrual basis accounting is a method where you record income when you earn it and expenses when you incur them, even if no cash has changed hands yet.

For example:

- **If a company sells products in December but won’t get paid until January, the sale is recorded in December because that’s when the company earned the money.**
- **If the company buys supplies in December but won’t pay until January, the expense is recorded in December because that’s when the supplies were used.**

What happens if we don’t use this method?

If we don’t use accrual accounting and only use cash basis accounting (where you record things only when cash is received or spent), you might get a misleading picture of how a company is doing.

Here’s why:

- **Timing mismatch: If you only look at cash in and out, your revenue and expenses won’t match the time they actually happen. A company could look super profitable in one month (when they collect cash) but then look like they’re losing money in another (because they delayed paying bills or receiving cash).**

- **Incomplete financial picture:** You wouldn't see future obligations (like bills that still need to be paid) or money that's coming in (like unpaid sales). This could make it seem like the company has more or less cash than it actually will soon have.
- **Difficulty in planning and decision-making:** Without accrual accounting, it's harder for businesses and investors to predict future performance. They wouldn't be able to tell how well the company is managing its earnings and costs over time, leading to bad decisions.

Conclusion:

accrual accounting gives a clearer, more accurate view of how a company is performing. Without it, you'd only see when cash moves, not the bigger picture of how a company is truly earning or spending money.