The cash and accruals alternative accounting bases: The strengths and limitations

Williams Abayaawien Atuilik,
Ph.D., MSc., MA, LLB, BSc., CA, CPA, CPFA, MCIT, ACIB, MGIM, FCCE, CEPA, BL

There are different bases of accounting used by public sector organizations for recognizing and recording financial transactions. These comprise: the cash basis of accounting, modified cash basis of accounting, accrual basis of accounting and the modified accrual basis of accounting (Tikk, 2010, p. 80). This paper examines the cash and accruals alternative accounting bases.

The cash basis of accounting recognizes and records transactions and events when cash is received or paid (Tikk, 2010, p. 80). It measures financial performance for a period as the difference between cash received and cash paid. The following strengths have been claimed for cash basis of accounting.

It is claimed that cash basis financial reports show in a direct way, the most critical information users need: the sources, uses and resulting balances of cash resources (Kwon, 1989). Additionally, cash basis financial reports provide a basis for comparison with budgetary appropriations helping to demonstrate whether or not there is budgetary compliance (Wynne, 2007). Moreover, the resulting financial statements are simple to prepare and use as they avoid estimates and therefore score high on the qualitative feature of understandability (Wynne, 2007; p. 29). Consequently, cash based accounting systems require relatively fewer employees and less sophisticated accounting skills compared with other bases of accounting. The cost of implementing cash basis accounting systems is therefore likely to be lower. Finally, there is increased objectivity in the financial position depicted by cash basis reports (Wynne, 2007). There are however some weaknesses.

It has been suggested that cash basis accounting does not lead to reliable measurement of performance as it focuses on receipts and payments of cash instead of service delivery (Bergmann, 2012). There is limited accountability as information on non-cash assets and liabilities are not provided (Wynne, 2007). There have been calls by IPSASB for migration towards accrual accounting because of weaknesses of cash based accounting systems.

Accrual basis accounting recognizes and records transactions and events when they occur rather than when cash is received or paid (IFAC, 2000). Revenue is recognized and recorded when earned while expenditure is recognized and recorded when incurred, usually at the time goods or services are received.
Accrual accounting, it is suggested, provides information which enables users to: assess the true and fair view of performance, financial position and cash flows of the reporting entity; and assess the entity's compliance with accrual budgets (Tikk, 2010; p. 83). It also provides information which: demonstrates accountability for use of all resources and management of all assets and liabilities; shows how the entity finances its activities and meets its liabilities and commitments (Tickell, 2010; p73; Wynne, 2007; p. 7).

Accrual accounting requires organizations to maintain complete records of assets and liabilities which are necessary for effective management of assets and liabilities (Wynne, 2007; p. 8). The recognition of all costs including depreciation ensures that operating costs are more reliably measured (Carlin, 2005; p.316). Andriani, Kober and Ng (2010, p.51); Belkaoui (1983, p.310) and Kober, Lee and Ng (2010, p.292) found that accrual accounting information is perceived to be more useful than cash accounting information in majority of decision situations. There are however some weaknesses.

It has been argued that accrual accounting is not suitable for use by non-profit oriented entities (Christiaens and Rommel, 2008; Hodges and Mellett, 2003). Producing accruals accounting financial statements requires significant investment in time, accounting systems and human capacity as a result of its relative complexity (Tickell, 2010; p.76). Accrual basis accounting fails to demonstrate whether or not there is compliance with cash based budgetary estimates (Paulsson, 2006; p.58). It has been argued that the claims of the usefulness of accrual accounting are yet to be supported by empirical evidence whilst the cost of accrual accounting reforms is clear and substantial (Carlin, 2005; p.313; Tickell, 2010; p.77; and Wynne, 2008; p.127).

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The writer is a Senior Lecturer, Department of Accounting, Faculty of Business Administration, Heritage Christian
atuilik@yahoo.com