

## **5. ACCRUAL BASIS — Guidelines**

This discussion on accrual basis is being presented separately in recognition of the fact that many NPOs keep their records on a Cash Basis but record accrual entries at the end of each reporting period to convert these records to an accrual basis. These accrual entries are recorded because financial statements will be distorted if unpaid bills or obligations actually incurred and uncollected income at the end of a period are not recorded.

Small non-profit organizations want to keep their records as basic as possible by implementing a system that combines the simplicity of cash basis bookkeeping and the advantage of accrual basis reporting.

### **5.1 Moving from the Cash Basis to the Accrual Basis**

If an NPO follows the Cash Basis, it is encouraged to voluntarily disclose accrual-based information, although its core financial statements will nonetheless be prepared under the cash basis of accounting. An entity in the process of moving from cash accounting to accrual accounting may wish to include particular accrual-based disclosures during this process. The status and location of additional information (for example, in the notes to the financial statements or in a separate supplementary section of the financial report) will depend on the characteristics of the information (for example, reliability and completeness) and any legislation or regulations governing financial reporting within a country.

### **5.2 Accrual of Revenues**

Revenues are recognized when they are earned regardless of when the cash is actually collected. Revenues must also be realized, meaning that the organization must, at some time in the future, be able to convert any receivables resulting from revenue recognition.

#### ***Accrual of Grants and Donations***

Accounting for grants and donations is a major concern of NPOs with regard to the accrual basis. NPOs record a donor's unconditional commitment to contribute as

revenue (and receivable), provided that the contribution is realizable and enforceable. Grants and donations may be accrued subject to the following conditions:

- completed contract; and
- fulfillment of conditions/agreements previously set forth

In many occasions, grants received (or a portion thereof) are intended for other periods other than the period that these are received. It may be that a grant remittance is intended to cover previous period activities or that it is intended for the next period/s.

### 5.3 Accrual of Expenses

Expenses recorded on the accrual basis of accounting follow three basic principles:

**First**, some expenses are recognized when they are “matched” to the revenue which they generate.

For example, if an NPO sells an item, the costs and expenses related to that item is recognized at the same time as the revenue from the sale is recorded.

**Second**, some expenses are recognized in the fiscal year or accounting period in which they are used by the organization. These types of expenses are recognized when the organization has an obligation to pay the expense, which will generally correspond to the period in which the organization receives the benefit of the expense.

For example, rental expenses should be recognized in the month or period in which the NPO occupied the rented premises. Another example is personnel cost which is recognized in the period the employees rendered their services. The same applies to utility expenses such as electricity, telephone, water, etc. which are paid on a monthly or regular basis.

**Third**, some expenses are the result of a systematic allocation of costs to accounting periods.

Depreciation expense related to the depreciation of fixed assets is the classic example of this type.

### 5.4 Accrual Basis and Liquidation of Cash Advances

One of the common problems in NPO accounting is the untimely liquidation of cash advances. When the accrual basis is used, it is paramount that liquidations should be prompt or immediately after the activity. Liquidation submitted very late defeats the benefits of the accrual basis described above.

***Important Note:***

As part of the accounting system, transactions to be accrued at the end of the reporting period should be documented in the NPO’s accounting manual. This will

serve as a guide in the preparation of necessary accounting documents and records for accrual purposes. In considering the accrual basis of accounting, the time of the actual cash receipt or cash disbursement does NOT determine in which accounting period a revenue or expense is recorded. Rather, the principles described above guide the recognition of revenue or expense regardless of when the actual cash is collected or disbursed.

Among others, the following items are considered when preparing accrual entries:

- Accrued Revenues/Income
- Periodic Costs/End of the Month or Period
  - a. Salaries and related costs
  - b. Rentals
  - c. Utilities
  - d. Retainer fees and other periodic expenses
- Portion of Prepaid Expenses consumed for the period (Prepaid expenses are treated as assets)
  - a. Consumed portion of supplies, inventories, prepaid tickets, etc.
  - b. Completed portion of prepaid contracts
  - c. Amortization of other prepaid expenses
- Recognition of expense or asset and related liability based on consumed or completed portion of an obligation.
- Provisions
  - a. Depreciation, impairment and amortization
  - b. Provision for doubtful accounts
  - c. Unrealized gains or losses such as foreign exchange gain or loss as a result of changes in the foreign currency balances as of balance sheet date

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**PRACTICAL EXAMPLES and PRO-FORMA ENTRIES**

	Debit	Credit
<b><i>Accrued Revenues/Income</i></b>		
1 _____ receivable	100,000	
_____ income		100,000
To accrue _____ earned from _____ for the period		
<i>(all other accrual of revenues, income, contributions follow this entry format, recognizing the specific revenue and the corresponding receivable)</i>		
2 Deferred Grant (liability)	500,000	
Grant (as revenue)		500,000
To recognize the portion of grant received that is intended for the period.		
<i>(this entry assumes that grant received was originally credited to Deferred Grant (a liability account) because the amount was intended for several periods)</i>		
<b><i>Periodic Costs/End of the Month or Period</i></b>		
3 Salaries expense	100,000	
SSS employer's contribution	7,000	
HDMF employer's contribution	4,000	
PHIC employer's contribution	3,000	
Withholding tax payable-compensation		15,000
SSS payable		14,000
HDMF payable		8,000
PHIC payable		6,000
Cash		71,000
To record payroll expenses and set-up liabilities to government arising from the payroll.		
4 Retirement Benefit expense	20,000	
Accrued expenses		20,000
To accrue retirement benefit expense for the period.		
5 Rent expense	10,000	
Accrued expenses		10,000
To accrue rent for the month of December.		
6 Power, light and water	8,000	
Accrued expenses		8,000
To accrue electricity and water charges for the month of December.		

	Debit	Credit
7 Professional fee		
Accrued expenses	5,500	
		5,500
To accrue retainer's fee for the month of December.		
<i>Consumed Portion of Pre-paid Expenses (the following entry assumes that pre-paid expenses were treated as asset when this was paid in advance)</i>		
8 _____ expense		
Prepaid expenses	40,000	
		40,000
To record consumed portion of prepaid _____ expense for the period.		
<i>Recognition of Expense or Asset and Related Liability Based on Consumed or Completed Portion of an Obligation</i>		
9 Interest expense		
Interest payable	20,000	
		20,000
To accrue interest incurred on Loans payable for the period.		
10 _____ (Expense or Asset)		
Accounts payable	50,000	
		50,000
To recognize completed portion of _____ expense or asset during the period.		
<b>Provisions</b>		
11 Depreciation expense		
Accumulated depreciation	20,000	
		20,000
To record depreciation of properties for the period.		
12 Bad debts		
Allowance for bad debts	10,000	
		10,000
To record provision for bad debts.		
13 Cash (foreign currency)		
Foreign exchange gain	5,000	
		5,000
To re-value foreign currency balance based on the current rate as of end of the period.		