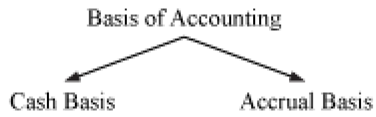
CHAPTER 5

BASES OF ACCOUNTING

❖ **Bases of Accounting**



❖ **Cash Basis** – In the cash basis of accounting, expenses are considered only when they are paid and not at the time when they are due. Similarly, revenues are considered only when they are actually received and not when the right of receiving them is established

❖ **Advantages of Cash Basis**

- Maintaining books under cash basis is comparatively easier and cheaper.
- More rational approach as it is based on actual cash inflows and outflows.
- A more suitable approach for entities with most of the transactions taking place in cash.

❖ **Disadvantages of Cash Basis**

- Fails to exhibit the true and fair view of the financial performance and financial position as it ignores outstanding and prepaid expenses and unearned and accrued incomes.
- This method is inconsistent with the matching principle of accounting.
- Cash basis of accounting allows easy manipulations of profits. To reflect a better financial position, payments may be delayed and amounts due may be collected before due dates and vice-versa.

❖ **Accrual Basis** – Under the accrual basis of accounting, expenses are considered only when they are due for payment and not when the payment is actually made. Similarly revenues are considered only when the right of receiving them is established and not when they are actually received.

❖ **Advantages of Accrual Basis**

- Exhibits true and fair view of the financial performance and financial position as it takes into account all the adjustments like outstanding and prepaid expenses and unearned and accrued incomes.
- Based on matching principle of accounting.
- Recognised by Companies Act, 2013.

❖ **Disadvantages of Accrual Basis**

- Determination of profits and losses under this method is a cumbersome process.
- This method is not free from personal bias.
- Various estimations are required to be made under this method.