

## What is the basis of accounting?

The basis of accounting is a method to determine when and how income and expenses are recorded and reported. Using a consistent accounting method is good practice; however, no entity must use one method over another. There are three accounting methods:

- ▶ **Cash method:** Income is recorded when received, and expenses are recorded when paid.
- ▶ **Accrual method:** Income is recorded when earned, and expenses are recorded when incurred.
- ▶ **Modified accrual method:** Income is recorded when earned and received, and expenses are recorded when they are incurred.

It is important to use a method that reflects income and expenses. Small business accounting needs can usually be met through cash accounting. An entity with an inventory that produces, purchases, or sells merchandise typically uses the accrual method.

## Can an entity change its method of accounting?

An entity can change its method of accounting but might need to follow some steps and requirements first. For example, if the entity is required to file a tax return with the Internal Revenue Service (IRS), it must obtain IRS approval to change the accounting method.

## Which accounting method is best for your organization?

It is best to consult with a tax professional or certified public accountant on the most appropriate accounting method for your organization. Consider the following when choosing an accounting method: The cash method is the easiest to use; however, it does not provide an accurate financial picture because it does not record payables and receivables.

- ▶ The **accrual method** accurately reports how much money is earned and spent. It also adheres to the Generally Accepted Accounting Principles (defined by the American Institute of Certified Public Accountants). However, it is a more complex accounting system than the cash method.
- ▶ The **modified accrual method** works well when accounting for inventory using the accrual method and recording income and expenses using the cash method.



## Resources

- ▶ [IRS: Publication 538, Accounting Periods and Methods](#)
- ▶ [DOJ Grants Financial Guide](#)

The **Office for Victims of Crime Financial Management Resource Center (OVC FMRC)** offers culturally humble, trauma-informed training and technical assistance to support OVC human trafficking and discretionary grantees. OVC FMRC services focus on enhancing financial management capacity.

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