**Accrual and Cash Accounting**

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**Accrual accounting**

Net earnings it not a measure of cash transactions. Instead, it measures a business’s performance for a period of time, taking into account the “wealth” a business creates (such as products that will eventually be sold) and the “wealth” a business loses (such as bills that will eventually be paid).

This is called accrual accounting, and the results are recorded on a business’s income statement.

**Cash accounting**

Accountants also measure cash flows, reporting them on the statement of cash flows. The statement reports the following:

• Cash generated from operating activities, such as payment from customers

• Cash spent in operating activities, such as payment to suppliers

• Cash generated from investing activities, such as the sale of property

• Cash spent in investing activities, such as the purchase of new equipment

• Cash generated in financing activities, such as the issuance of a company’s own shares

• Cash used in financing activities, such as a payout of dividends

**Income statement vs. cash flow**

Wealth flow (the income statement) and cash flow (the statement of cash flows) don’t have to occur during the same accounting period. For example, Boeing may receive cash from a customer this year (the current accounting period) as a deposit to build an airplane, then build and deliver the airplane next year. Next year the income statement will report wealth created as revenue, less expenses of building the airplane. But the customer will likely pay for the airplane (less the deposit) over future years. The result is that cash flow and wealth flow occur at different times.

In general, a business is considered to be healthy if the amount of cash coming in is higher than net income.