



THE FORESIGHT COMPANIES, LLC

Accounting Newsletter

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When Accrual Accounting is Not Accrual Accounting—by Dan Isard

Hopefully you have at least a basic understanding of the two types of accounting methods; accrual and cash. Cash is where we recognize income when it is received and expenses when they are paid. It is simple.

We generally like the cash method of tax filing as it has a realistic approach to your real taxable income earned. Accrual is a bit more complicated.

With Accrual accounting you are deemed to have earned income when you have the right to receive it and you accrue the expense when you create the obligation to pay expense. Yet, many of our accrual accounting clients are not doing accrual properly.

Imagine you meet with a family January 15th and they arrange a

\$7,000 funeral. You go into your inventory and take out a casket that costs you \$1,500. You reorder that casket from your provider and it comes in your next shipment.

About 30 days later you get billed for that casket and a bunch more. About 30 days after that, near the end of March, you pay the outstanding casket bill.

In January you did not give us the information on the casket that the family purchased from you on January 15th. Therefore, you don't get that deduction until the month of March when you paid the outstanding casket bill.

If we look at your profitability in January, it appears you were a genius! You had high revenue

and a low Cost of Goods Sold so your Gross Profit was phenomenal!

Then along comes March and you look like a terrible business owner. Your revenue might be consistent but Cost of Goods Sold is way high so Gross Profit may be way low!

This might not seem like a problem for tax payment, since the January merchandise is going to be paid before the year end. But keep in mind, if you have a slow last quarter, all of the ratios are going to be off! The same error from January will befall November and December.

We encourage you to think accrual. So, if you want, for 2015, resolve to record all casket sales on the accrual basis. Keep track and record what is sold as Cost of Goods Sold each month, not just as your casket bill is paid. That works best for management purposes and it will level out your profit!

Happy New Year everyone!

