



## Basis of Accounting

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Dear Reader:

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We hope this information will be useful to you; reference to it will assist you with many of the questions that will arise in your tenure with municipal government. However, the *Tennessee Code Annotated* and other relevant laws or regulations should always be consulted before any action is taken based upon the contents of this document.

Please feel free to contact us if you have questions or comments regarding this information or any other MTAS website material.

Sincerely,

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**Reference Number:** MTAS-626

There are two types, or bases, of accounting: cash and accrual. The cash basis is used by individuals and small businesses. Cash accounting records only cash in and cash out. It is limited in that some financial events would not show up under cash basis accounting. Tennessee cities and utilities use accrual accounting of which there are two types: accrual and modified accrual.

At the fund level of reporting, the general fund uses the modified accrual basis method of accounting. The “modification” is primarily in the recognition of revenue. It’s all about the budget at the general fund level, and only money available during the budget year can be booked as revenue.

General fund revenues are recognized only when they are available to liquidate liabilities of the budget year. Expenditures should be recognized in the accounting period in which the liability is incurred. The main reason for this is that most city budgets are balanced with property taxes. It is very important to tie the property tax rate to the service being provided during the budget year.

The private sector, enterprise funds, and the government-wide financial reports use the accrual basis of accounting. Revenues are recognized when they are earned and measurable, and expenses are recognized when a liability is incurred. Because enterprise fund revenue is generated from users (not taxes), there is an implicit understanding that rates will increase as necessary.

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