Accrual Method of Accounting

Accounting 580T – Lectures 7 and 8
Gertzman: Chapter 4
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Accruing a Liability
- All events test
- Economic Performance

Fact of the Liability
- Liability must be fixed
  - Identification of payee
  - Likelihood of performance
  - Conditions subsequent
  - Conditions precedent
Fact of the Liability

- **Matching**
  - Very important in early cases
  - Overriding the matching concept –
    - Certainty of the liability
    - Economic performance

Fact of the Liability

- **Contested Liabilities**
  - No deduction
  - Bona fide dispute is a contest
  - Lawsuit not necessary

Fact of the Liability

- **Payment of Contested Liability**
  - Three criteria for deduction
  - Must also meet economic performance test
Fact of the Liability

- Resolution of the Contest
  - Establishes the fact of the liability
  - Resolution takes place when –
    - Final determination
    - Acknowledgment

Reasonable Accuracy

- Must Be Determinable With Reasonable Accuracy
- Deduct a Reasonable Estimate
- Possibility of Adjustment

Economic Performance

- Liability Not Incurred Until Economic Performance
- Why Have an Economic Performance Requirement?
Economic Performance

- **Time of Economic Performance**
  - Where services and property are provided to the taxpayer
  - Three and one-half month rule

- **Time of Economic Performance**
  - Where services and property are provided by the taxpayer
  - Workers comp and tort liabilities

- **Recurring Items**
  - Treated as incurred if:
    - Item is recurring
    - Economic performance occurs —
      - By the time the tax return is filed
      - Eight and one-half months after year end
Economic Performance

- **Recurring Items**
  - Treated as incurred if –
    - The all events test is met
    - Either –
      - The item is not material, or
      - Accrual results in better matching