What Is An Accrued Expense?

In the days of paper and pencil, managing accounts payable using accrual accounting meant long hours not only recording expenses as they occurred, but also reconciling those entries when the expenses were finally paid. Manual accounting methods meant a missed or incorrect journal entry could leave a business with inaccurate financial statements for multiple accounting periods.

Ensuring your accrued expenses, along with your balance sheet as a whole, is as accurate as possible takes care and precision. With the growing use of digital accounting tools, however, the process is easier, faster, and more accurate than ever before.

Accrued Expenses: The Basics

Forming the foundation of the accounts payable (AP) method known as *accrual accounting,* accrued expenses are those which have been incurred in a given period, but not yet paid or recorded in your company's general ledger. They're also known as *accrued liabilities*, and are recorded as current liabilities on the balance sheet.

Two entries are required for each accrued expense:

- A debit entry to record the expense when it occurs
- A payable entry, recorded as a credit, to reconcile the transaction

Accrued expenses often arise from the very common business practice of buying and selling on credit. Some examples of accrued expenses include:

- The cost of goods and services for which an invoice has not been issued
- Interest payments on outstanding loans
- Staff and contractor wages
- Tax payments for which no invoice has been issued

An accrued expense appears in the general ledger and in the company's financial statements only if it's been reconciled in an accounting period *before* the financial statements are issued.

Contrast this with *prepaid expenses*, which are those expenses for which payment has already been issued, but the goods or services paid for have not yet been received or used. As a result, these prepaid expenses are recorded as assets, rather than liabilities, on the balance sheet.

Accrued expenses are also distinct from *deferred revenue*, which is pre-payment received in advance of goods or services delivered to your company's customers. It moves from the balance sheet to the income statement as *earned revenue* once the goods or services have been deployed to the customer.

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Detailed Examples of Accrued Expenses

One of the more typical instances where an accrued expense would be recorded is receiving a loan. Let's say your company's accounting end of year falls on the *actual* end of the year, December 31st.

Your business acquires a $500,000 loan to finance materials, working capital, and services for a major project on December 14th. The loan, plus $7,000 of accrued interest, is scheduled to be paid on a later date: January 31st of the following year, in a new accounting period.

When December 31st (the end of the accounting period) rolls around, your company will not yet have received an invoice, and will not have paid either the premium or the interest on the loan. To reconcile this with the company's balance sheet and conform to the accrual basis of accounting, an adjusting entry must be created like so:

- A $7,000 *debit* entry is made to the income statement under Loan Interest Expenses, dated December 31st.
- A $7,000 *credit* entry is made to the balance sheet under Interest Payables, dated December

31st.

When January 31st arrives and it's time to pay off the loan, two more adjusting journal entries (sometimes referred to as *reverse* or *reversing entries*) are made:

- A $7,000 *debit* entry is made to your company's income statement under Loan Interest Payables, dated January 31st.
- A $7,000 *credit* entry is made to the balance sheet under the name of the lending institution, dated January 31st.

To take another example, let's say your company ordered stationery for the office on March 17th, totalling $2,700. At the end of March, you still haven't received an invoice from the vendor. In this instance, you'd create the following entries:

- A $2,700 *debit* entry is made to the income statement under Office Supply Expenses, dated March 31st.
- A $2,700 *credit* entry is made to the balance sheet under Accrued Expenses, dated March 31st.

The following month, on April 20th, you receive an invoice for the office supplies and issue payment. The reversing entries to be made are:

- A $2,700 *debit* entry is made to the income statement under Accrued Expenses, dated April 20th.
- A $2,700 *credit* entry is made to the balance sheet under Office Supply Expenses, dated April 20th.

The invoice is processed through accounts payable as normal, and the "time-shifted" liabilities recorded and adjusted to reflect both when the expense was incurred and when it was actually paid.

Improving Efficiency and Accuracy with Automation and AI

Depending on your accounting workflows, your accrued expenses might represent a significant commitment of time, labour, and energy for your accounting team—especially if you're still relying on manual or ageing tech solutions to help you get the job done.

Enter accounts payable automation. Using artificial intelligence and centralised, cloud-based document management, it's easy and intuitive to streamline all your workflows, including accruals. Consider these benefits that will help optimise your AP function:

- Cloud-based document storage, cross-connectivity, and on-demand, levelled access from both desktop and mobile applications make accessing, analysing, and verifying data a snap.
- Both rogue spend and fraud are reduced or even eliminated thanks to advanced supply chain

management tools and fully transparent transaction tracking. No more duplicate transactions or missed entries in the balance sheet or general ledger. All spend is recorded, verified, and ready for incorporation into reports, forecasts, audits, and more.
- Inefficiencies and errors drop dramatically thanks to automated workflows replacing manual data entry and verification. Expenses are logged when they occur, reconciled when paid, and fully connected to all other relevant transaction data for optimal strategic procurement as well as financial analysis and reporting.

Activate Optimal Accruals

Buy today, pay tomorrow—and leave errors, omissions, and inefficiency for the twelfth of never. Taking control of your accrued expenses, along with the rest of your accounting and procurement roles, begins with integrated digital solution that connects your staff, data, and workflows into a cohesive and complete powerhouse of productivity.

Automate Your Accounts Payable for Greater Accuracy with PurchaseControl

Find Out How

— About **PurchaseControl**

PurchaseControl is cloud based procurement software for business spend management. We empower businesses by providing greater transparency and oversight into the purchasing process. With PurchaseControl, you have the flexibility to manage how spend actually happens instead of how you wish it would happen.

The entire PurchaseControl team has experience within a range of businesses, and as such, we bring a practical, holistic approach to purchasing. We understand what it takes to run a business and apply that knowledge to make PurchaseControl as effective as possible for all users.

Learn more at www.purchasecontrol.com

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