

Instructions for Preparing an Accrual to Cash Income Conversion

There are two sections to this report which must produce the same result. If they do not, then you are missing something.

STEP 1 – CODE YOUR BALANCE SHEET ACCOUNTS

CAVU can provide guidance on this, but it is critical to receive the concurrence of the company's tax accountant. For instance, some tax advisors consider 401K accrual an adjusting item and some consider it a permanent item.

- Code every balance sheet account with an A for **Adjusting Account** or P for **Permanent Account**.

STEP 2 – SET UP THE ADJUSTMENT TO NET INCOME SECTION

This section starts with the accrual net income amount for the current year and is adjusted for A items.

- The first line is **Current Year Net Income** (Accrual income per books).
- Create a section that lists all A items. Insert previous year-end amounts with assets having a positive balance and liabilities having a negative balance. Add this section up.
- Create the same for the current year-end amounts using the same list of all A items. Insert current year-end amounts with assets having a positive balance and liabilities having a negative balance. Add this section up.
- The last line is **Taxable Income Before Permanent Differences and Other Tax Adjustments**.
This line is:
 - Net Income Per Books
 - + Previous Year Total
 - Current Year Total
 - = Taxable Income Before Permanent Differences and Other Tax Adjustments

STEP 3 – SET UP THE CASH CHECK SECTION

- Create a section that lists all P items. Insert previous year-end amounts with assets having a positive balance and liabilities having a negative balance. Add this section up.
- Create the same for the current year-end amounts using the same list of all P items. Insert current year-end amounts with assets having a positive balance and liabilities having a negative balance. Add this section up.
- The next line is **Previous Year Net Income Per Books**. Note, you only use the previous year net income and not the current year net income. The reason is that previous year net income is rolled into retained earnings for the current year. This allows for a complete comparison.
- The last line is **Balance Sheet Changes**. This line is:
 - Previous Year Total
 - Current Year Total
 - + Previous Year Net Income
 - = Balance Sheet Changes

STEP 4 – VARIANCE

- Subtract the result from Step 2 (Taxable Income Before Permanent Differences and Other Tax Adjustments) and the result from Step 3 (Balance Sheet Changes).
- The variance is \$0 (If done correctly).