

Charting Your Ministry

© 2007 by Nick B. Nicholaou, all rights reserved

President, Ministry Business Services, Inc.

Reprinted from *The NACBA Ledger*

While helping churches refine their general ledger chart of accounts, there are two issues that need to be wrestled through nearly every time:

- The level of detail in their chart, and
- Cash or accrual accounting—which would be best for them?

Detailed Chart of Accounts

During this process we encourage clients to re-think each account asking the following two questions:

1. Do we need the account to satisfy a legal or accountability issue?

Accounts we might include for this reason are:

- Petty cash accounts,
- Restricted fund accounts, and
- Any accounts our governing board mandates.

2. Do we need the account for budgetary control purposes?

- Accounts we might include for this reason are income and expense accounts whose budgets will affect the decisions we make throughout the year. These are the accounts on the Income Statement (in the not-for-profit accounting world, this report is called Statement of Activities).
- Accounts we might exclude are those that do little more than compartmentalize income or expense items that aren't paid much attention to. An example would be an income account for the few dollars received each year through the offering plate located next to the “free” devotionals at the entry to the church.

In either case, be sure to provide the right amount of detailed budget accounts to help your team manage the budget without overwhelming them with unnecessary minutia.

Understanding Cash vs Accrual Accounting

If you check with your CPA, he or she will likely tell you that your books need to be kept according to GAAP (Generally Accepted Accounting Principles), and that means accrual accounting. Simply put, accrual accounting means recording income and expense transactions in the period in which the income was earned or the expense was incurred.

Accrual accounting works like this:

- Step 1. When you receive an invoice in January that won't get paid until February, the expense would be recorded in January along with a corresponding liability, such as *Accounts Payable*, on the Balance Sheet (in the not-for-profit accounting world, this report is called Statement of Financial Position).
- Step 2. When the invoice is paid in February, the two accounting entries would be on the Balance Sheet alone, reducing both *Cash in Checking* and *Accounts Payable*.

In cash accounting, nothing would be recorded for this entry until the invoice is paid in February. At that time the expense would be recorded with a corresponding entry that reduces *Cash in Checking*.

Accrual accounting also requires that capital purchases be recorded directly to the Assets section of the Balance Sheet and then be depreciated on the Income Statement over their anticipated “useful life”.

If your ministry has a CPA perform an audit or review, the CPA will want to present financial statements reflecting accrual accounting. Accrual is required by GAAP, and GAAP is what CPAs are required to comply with. If you want a clean audit (referred to as *unqualified* because the financial statements can be relied upon without any qualifying remarks), accrual is your only option.

Modified Cash Accounting

Unfortunately, many of the volunteers who sit on governing boards and who work in ministry are often confused by accrual financial statements. The two most common mistakes made are:

- They sometimes look at the amount of cash on hand and make management decisions based on that without understanding the impact of the outstanding obligations whose expenses have already been recorded.
- They sometimes look at large purchases whose transactions went straight to the Balance Sheet and misapply the budget.

Many ministries prefer to use a modified type of cash accounting. They operate on a cash basis throughout the year to help their management teams in their decision-making processes, and then make “period 13” adjustments that move capital purchases to the Balance Sheet (period 13 refers to the period outside of their budget cycle). Those who get audits or reviews will have their CPA do the necessary work to present their reports in accrual basis to satisfy GAAP, keeping the “outside world” happy. **Helpful Hint:** If you operate using a modified cash method, you might save money by asking your CPA to teach you how to provide them with your accounting in accrual form for the audit or review process.

Challenging your chart of accounts with these questions in mind can help simplify your accounting process, freeing resources to do more of that which truly counts while empowering decision makers to build the Kingdom.