

Overview of the Bookkeeping Function

Keeping the books of an organization is a simple concept to visualize: we can all conjure up the image of an oversized ledger on a desk, and the bookkeeper, wearing a green eyeshade, adding columns of figures. A more modern image is of a worker sitting in front of a computer screen with piles of paper on the desk. But what exactly is bookkeeping?

Bookkeeping is the systematic recording of transactions that affect the financial operations of an organization. While most of these transactions are monetary, nonprofit organizations also receive non-monetary donations (for example, volunteered time) that also must be recorded if they meet certain criteria. Later on, we'll explore what gets recorded, how it gets recorded, and even when it should be recorded; but for now let's examine why bookkeeping is important.

Every organization needs a method of tracking and understanding day-to-day operations. Monetary transactions can take many shapes, but they generally fall into four major categories:

- Cash received
- Cash disbursed
- Cash due to be received (accounts receivable)
- Cash due to be disbursed (accounts payable)

Theoretically, tracking the cash balance of an organization is the bare minimum you need to do to keep the organization going. You could accomplish this by simply putting all incoming cash into a shoebox, and paying all expenses by removing cash from that shoebox. Count up what's left in the box, and you have your current cash balance.

In the real world, this minimum knowledge is not only impractical but also totally inadequate. To manage the organization effectively, to plan future events, budget, to analyze, to file a tax return, more information and more skills are required.

Nonprofit organizations have a large number of different stakeholders: clients, community members, funders, board members, staff members, volunteers, and (in many states) the attorney general. The Internal Revenue Service, after many years of

paying little attention to nonprofit organizations, has more aggressively started enforcing the laws and regulations governing nonprofits. Even small nonprofit organizations are in the public eye to a far greater degree than small businesses are. Each stakeholder needs information, and the accounting system is the primary source of that information.

Communication is essential to the management of any organization. While this chapter focuses on the flow of information from the accounting system to stakeholders, it is equally important for information to flow from stakeholders into the accounting department. Transaction details are just one such type of that information. In a well-managed nonprofit, communication helps the bookkeeper anticipate situations and provide management with the information and analyses needed to run the organization effectively.

Users of the Information

Who are the users of a bookkeeping system's information? The bookkeeper uses financial information all day long. Accountants analyze the information the bookkeeping system produces. Managers use the information to assess past results and to plan for the future. Board members use the information to monitor the financial performance of the organization in comparison to its official budgets. Others—the IRS, banks, lenders, funders, government officials, and the general public—all need access to reliable information generated by the bookkeeping system.

Program managers and department heads benefit greatly when they understand why and how to properly record transactions. Their own performance may be reviewed using financial information. They may evaluate personnel and program effectiveness by looking at the numbers, among other factors. When asked to prepare next year's program budget, the manager relies heavily on this year's financials. Applying for a new grant means the manager must analyze, project, and justify financial information that is based on historical bookkeeping data.

Bookkeeping, Accounting, Auditing: Who Does What?

Bookkeeping, accounting, and auditing are three processes that may appear to overlap, especially in a small organization. They accomplish different goals, but they use the same information. There is not a clear line of demarcation between bookkeeping and accounting. Depending on the size of your organization, one person might perform both functions. Based on recent changes in auditing standards, your organization needs to carefully monitor the role you are asking your auditor to play. Certain funding sources and just plain common sense prevent auditors from playing too prominent a role in bookkeeping and accounting services.

Accountants are often employees of the organization who supervise the bookkeeping function in addition to other responsibilities. They normally perform a more

analytical function than *bookkeepers*, who primarily deal with the posting of transactions. Accountants begin with the accounting information (ledgers and journals) and analyze the results, looking for causes and effects. They also are responsible for maintaining the accounting information so that it can be used to generate financial statements for anyone who needs them.

Auditing is an attest function; *auditors* examine the books and determine whether the financial statements derived from those books conform to GAAP (generally accepted accounting principles) and accurately reflect the financial position of the organization. GAAP is a set of commonly accepted standards, principles, and procedures promulgated by the Financial Accounting Standards Board (FASB). Auditors must be independent of the organization, and should report to the board of directors with input from the president or executive director. Auditors use GAAS (*generally accepted auditing standards*) promulgated by the Auditing Standards Board of the American Institute of Certified Public Accountants (AICPA) and *Government Audit Standards* from the GAO (Government Accountability Office) and other standards required by funding sources or governmental agencies in auditing nonprofit organizations.

The Nonprofit World

Nonprofit organizations exist to fulfill a mission. In the business world, a for-profit enterprise is ultimately concerned with making a profit in order to provide a return on the owners' investment; if a product or service is not profitable, the for-profit enterprise will shift gears and sell something else. The nonprofit organization is committed to its "product or service"; it focuses on obtaining and allocating resources to get the job done. The goal of the nonprofit organization is to improve society without a profit motive.

There are many types of nonprofits. Some are direct service providers (hospitals, day care facilities); others collect and distribute resources (United Way, funding organizations); and still others are social organizations (local community clubs). Each nonprofit is organized to accomplish a specific mission, and money is one of the main resources used. How the money is collected and spent depends on many factors:

- Community needs
- Current events
- Funding source requirements
- Financial planning
- Budgeting
- Cash flow forecasting

In financial operations, a nonprofit organization is very similar to a for-profit enterprise. All organizations need to be financially healthy to function effectively. For-profit firms seek to maximize their net profits. Nonprofit organizations seek to

minimize or eliminate any operating deficits, because they cannot fulfill their mission if they have inadequate resources. In reality, a nonprofit organization uses profits (called *increase in net assets*) to provide resources for future periods.

This is an important point that unfortunately is often misunderstood. Peter F. Drucker has underscored the point that every organization needs to have an economic basis. Many organizations interpret their *nonprofit* status to mean that it is improper to show an excess of income over expenses. That makes no economic sense. Any organization, nonprofit or for-profit, needs reserve funds to handle emergencies. Organizations also need surpluses to fund new and innovative ideas (Drucker calls these *opportunity budgets*). (We will explore this point in more depth in Chapter Thirteen, where we discuss operating budgets.)

Nonprofit organizations apply for tax-exempt status from the Internal Revenue Service. (For more details, see Resource E.)

Terminology

While the terminology used in nonprofit accounting is sometimes different, many of the same accounting concepts apply to both the for-profit and the nonprofit world. As we mentioned, nonprofit organizations can generate a net profit or a net loss, only they call them increases or decreases in net assets. Most accounting terms are the same, and often bookkeepers coming from a for-profit work experience can quickly grasp the differences. We'll explore this topic in more depth throughout the rest of this book.

The Goal of Bookkeeping

Whether nonprofit, or for-profit, the primary goal of bookkeeping is the same:

To capture each transaction one time in a way that is fully documented, completely traceable, and fully usable by every person within and outside the organization who has a stake in the organization.

Let's break that goal down into its components.

Capture Each Transaction. As we mentioned earlier, bookkeeping is about recording monetary transactions. As the bookkeeper, you need a system in place that not only records a transaction; you need a system that helps you record every transaction. A missing transaction is a bigger problem than an incorrectly recorded transaction.

One Time. Ideally, you should deal with a transaction just one time, recording everything you need right then. Remember that there are many potential users of the information you are gathering; your bookkeeping system should be designed with each of those potential users in mind.

Fully Documented. Each transaction should be backed up by appropriate information. The organization's internal control system will specify the details of the documenta-

tion, but you should be satisfied that someone looking at the transaction at a later date could see what happened, how it happened, and when it happened without relying on anyone's recollection.

Completely Traceable. As transactions are recorded, either manually or electronically, you need a method to find your way back to the originating entry. Every total in the general ledger and every amount on a financial statement means something. The total usually represents a number of transactions; you need to be able to dig down and examine the individual transactions that make up the total.

Fully Usable. This is the complex part about designing a bookkeeping system. You need to stand back and take a look at the organization: who funds it, who runs it, who oversees it, and so on. Your system has to provide information to a wide variety of users in a form that they require. Here is a brief example:

Your organization employs a driver. The driver spends approximately one-half of the day working for Program A; approximately one-quarter of the day working for Program B; and the remainder of the day working for Program C. As you process the payroll, you'll charge the driver's gross pay to an expense category called *Driver Wages*. This satisfies some reporting requirements; it might be enough information to provide a financial statement to a bank or to file a payroll tax form.

Without capturing more information, how can you report to the funding source for Program C? How will the program managers plan their operations; how will they prepare future budgets?

Of course, if acceptable to a funding source, you might be allowed to estimate an allocation of the driver's gross pay, and in some cases the result would be the same. You'll make a judgment about when to capture details and when to allocate, but for items such as gross pay it is generally better to capture the details. Work schedules change; employees come and go; rates of pay change throughout the year.

If your organization receives money from federal, state, county, or city governments, some very detailed cost-definition and cost-allocation rules exist. (See Resource G for more information.)

The Bookkeeper As Information User

The bookkeeper represents the most basic user of an accounting system's information. Having up-to-date balance information—whether petty cash, cash in a checking account, cash in a savings account, accounts receivable, accounts payable, loan balances, lines of credit, or other balances—is essential to the bookkeeper's role in the organization. You'll constantly be checking these balances and reconciling them to more detailed sources (such as the accounts receivable detail report) or documents prepared by third parties (such as the monthly bank statement).

Management relies on the bookkeeper to summarize certain information and to provide frequent snapshots of balance statuses. A very useful report that many bookkeepers produce for management has the information shown in Exhibit 1.1.

EXHIBIT 1.1 Snapshot Report from Bookkeeper to Management

Date	
Cash in Bank	
Total Accounts Receivable Balance	
A/R Current (Less than 30 Days)	
A/R Between 30 and 60 Days	
A/R Over 60 Days	
Total Accounts Payable Balance	
A/P Due in 15 Days	
A/P Due Beyond 15 Days	

Using today's computer software, producing this type of snapshot report takes only a few minutes if your books are properly set up. The information is gathered from various accounting reports, such as the Trial Balance, the Aged Accounts Receivable (A/R) Report, and the Aged Accounts Payable (A/P) Report. Tasks that used to take a bookkeeper hours to do, such as adding up vendor ledger cards to produce the Accounts Payable Aged Invoice report, are now accomplished by the software with a few mouse clicks. This gives the bookkeeper time to investigate the anomalies: the very old vendor invoice or the accounts receivable balance that is now 120 days past due.

Other Information Users

As we mentioned earlier, the organization's managers will frequently be using the information from the accounting system.

Cash Flow Management. This is an essential function, and management needs accurate information about cash, A/R, and A/P in order to do it properly. Most enterprises that fail, both nonprofit and for-profit, do so because of a lack of adequate cash flow. Even when the organization is generating a surplus of revenues over expenses, inadequate cash flow can result. Timing is the key to good cash flow management. Payroll is often disbursed every two weeks; some vendors have very short payment terms (such as seven days); yet some funding sources only send in their checks every few months. Without adequate cash flow management, the organization could run out of cash, despite a financial statement (prepared on an accrual basis of accounting) showing an increase in net assets. This is a very important topic. (Chapter Fourteen discusses the concept in much greater detail.)

Budgeting. All nonprofit organizations should prepare accurate and complete budgets. The more successful nonprofits prepare budgets for every aspect of the organization.

Budgeting is a means of financial planning, and, with a proper reporting system, it is a means of evaluating results. We devote an entire chapter (Chapter Thirteen) to the topic.

Pricing Services. Without quality cost information, management would not be able to price services accurately. As in any organization, you want to price the services you offer at a point that covers all of your costs. There is no room for the old joke, “We lose money on each sale, but we hope to make it up with volume.” (Since nonprofit organizations meeting specific IRS guidelines can solicit and accept donations and grants, necessary but unprofitable services can be subsidized.) The nonprofit typically tries to price services at a point where the targeted clientele can afford them. Frequently, nonprofit organizations adopt a sliding scale for services to accommodate clients on an ability-to-pay basis. So the price must be not too high, nor too low. A careful ongoing analysis of the accounting information helps management to determine what to charge.

Fundraising. The fundraising effort requires the use of quality accounting information. Fundraising costs are a major factor, but so is accurate information about prior funding performance, pledge collections, and program results. Showing a funding source the financial results from a program they previously funded, combined with an impact study showing the program’s efficacy, often goes a long way toward securing future grants. The IRS and the Attorneys General of many states have become very interested in organizations accurately identifying fundraising costs.

Organization Planning. Organizations need to focus on what they do best. A careful analysis of the financial results for each program and department in the organization helps the board of directors and senior management to steer the nonprofit into areas where it can do the most good.

Financial Reporting. At the program level, at the department level, and the organization level, financial reports drive planning, budgeting, and operations. As we mentioned earlier, the staff accountants start with the information recorded by the bookkeeper and produce interim and year-end financial statements. They typically also provide budget-versus-actual (variance) reports to program managers and department heads on a regular basis. The auditors examine the year-end financials and issue a report to the Board of Directors and management. The auditors also prepare annual reporting forms (depending on the organization’s IRS classification and size). This financial reporting all begins with the bookkeeper’s work.

Staying Organized

A well-planned and implemented accounting system will include an accounting manual with properly designed internal controls, standard operating procedures, and financial policies. The fundamental role of the bookkeeper is to record the monetary transactions according to the internal controls following the accounting manual and to stay organized.

What does staying organized mean? For the bookkeeper, it means you must do the following:

- Be accurate
- Keep up to date
- Obtain documentation
- Ensure traceability
- Check authorization
- Check budget for availability of funds
- Obtain proper approvals
- Enforce policies and procedures

Let's examine each of these guidelines in detail:

Accuracy. This is the most highly prized attribute you can find in a bookkeeper. As the transactions multiply and accumulate, accuracy is essential. The bookkeeper has to take the time to understand the transaction being recorded—what it represents, where it should be entered (in terms of program, department, and overall classification), and who the responsible party is. Over time, the bookkeeper's knowledge about these details will make the accounting information extremely accurate; it will also allow the bookkeeper to become a valued contributor to the process of running the organization.

Timeliness. Information is the most valuable when it is current. Last week's cash balance doesn't tell you enough when you need to know the current balance. In the normal course of operations, no one is capable of being completely up-to-date in all areas, so the bookkeeper (working with management) can assign priority levels to various tasks. The bookkeeper also has a responsibility to inform management if certain tasks start to fall through the cracks due to an excessive workload.

Documentation. Bookkeepers must make sure that all documentation for a transaction is as complete and understandable as possible. Memories fade over time, so if it isn't written down, it will be lost eventually. Certain transactions naturally lend themselves to proper documentation; in other cases, the documentation is only complete if you take the time to request it. A typical example is the purchase of goods: there should be an authorized purchase order, the vendor's packing slip, a receiving document, and a vendor invoice (with proper approvals). Depending on the organization and on the purchase, some of this documentation might not be available. Look for guidance in the accounting manual. When in doubt, try to obtain full documentation.

Traceability. There should be no magic numbers in your accounting information. Every balance, every total is made up of real events; you should be able to work your way

back from the total to the individual transactions. For everyday transactions, this is seldom an issue. The unusual event, if not documented properly, often leads to an inability to trace what happened. What seems obvious when you post it can become a “where-did-that-number-come-from?” item in a few short weeks.

Authorization. The bookkeeper should have a written list of individuals who can authorize the various transactions that occur in the organization. Several types of transactions must be authorized prior to the event; a basic knowledge of the authorization process and of the parties involved will aid the bookkeeper in understanding and recording the transaction. Including the bookkeeper in staff meetings will help the bookkeeper to understand everyone’s role.

Budget Availability. Nonprofit organizations use budgets in the traditional sense, as a planning tool; but budgets also control cost reimbursement from various funding sources. It is important to check the budget to make sure there is room for the transaction. The bookkeeper, a program manager, or another staff member takes an active part in the process, depending on the size of the organization.

Approvals. Many transactions typically involving the disbursement of funds require written approval. Distinct from an authorization, an approval says that the transaction is correct and complete. In the case of a purchase of goods, the approval says that we received the correct items, that the items were satisfactory, that the item count is correct, that the unit price is as anticipated, and that the vendor’s invoice can be paid in a timely manner.

Enforcement. The bookkeeper plays a pivotal role in the enforcement of internal controls, the policies and procedures designed to safeguard the organization’s assets. An effective bookkeeper must be able to insist on adherence to the rules specified in the accounting manual by *every* member of the organization, regardless of the person’s position. When fraud occurs, a common contributing factor is the inability of the accounting department to “stand up to” the boss and insist on compliance with the rules.

Common Bookkeeping Functions

We’ll be covering the most common bookkeeping functions in more depth in later chapters. To complete this overview, here is a brief description of several common bookkeeping functions.

Cash Disbursements. The typical organization disburses funds on a weekly cycle through a check-writing process, with the occasional single disbursement occurring between check runs.

Posting Vendor Invoices. Vendor invoices are posted to the accounts payable system throughout the month.

Billing for Services. Billing for services includes creating and posting client or customer invoices to the accounts receivable system. Depending on the organization and on the service, this invoicing is done as the service is rendered or on a periodic billing cycle.

Recording Cash Receipts. Recording cash receipts includes crediting open accounts receivable items for payments received from customers or clients, as well as recording miscellaneous cash receipts. These transactions are typically posted every day.

Bank Reconciliations. This task involves analyzing the difference between the balance on a bank statement and the general ledger balance for a cash account. This is typically done once per month.

Account Analysis. As the name implies, account analysis means analyzing certain general ledger account balances to ensure that they are correct or to explain the details that make up the account balances. This is typically done once per month.

Petty Cash Reimbursement. Petty cash reimbursement involves adding up the vouchers and the remaining cash in the petty cash box, making sure the total matches the imprest (standard, unchanging) amount, then classifying and recording the transactions on each voucher into the correct general ledger account and writing a check to replenish the petty cash balance. This activity is done as necessary.

Summary

This chapter has presented you with an overview of the bookkeeping function. Every organization is unique, but they all have one thing in common: the need for a well-designed, accurately maintained accounting information system.