

QuickChurch Accounting

A Guide to Learning Church
Accounting and QuickBooks

QuickChurch Accounting

Nate Waddoups
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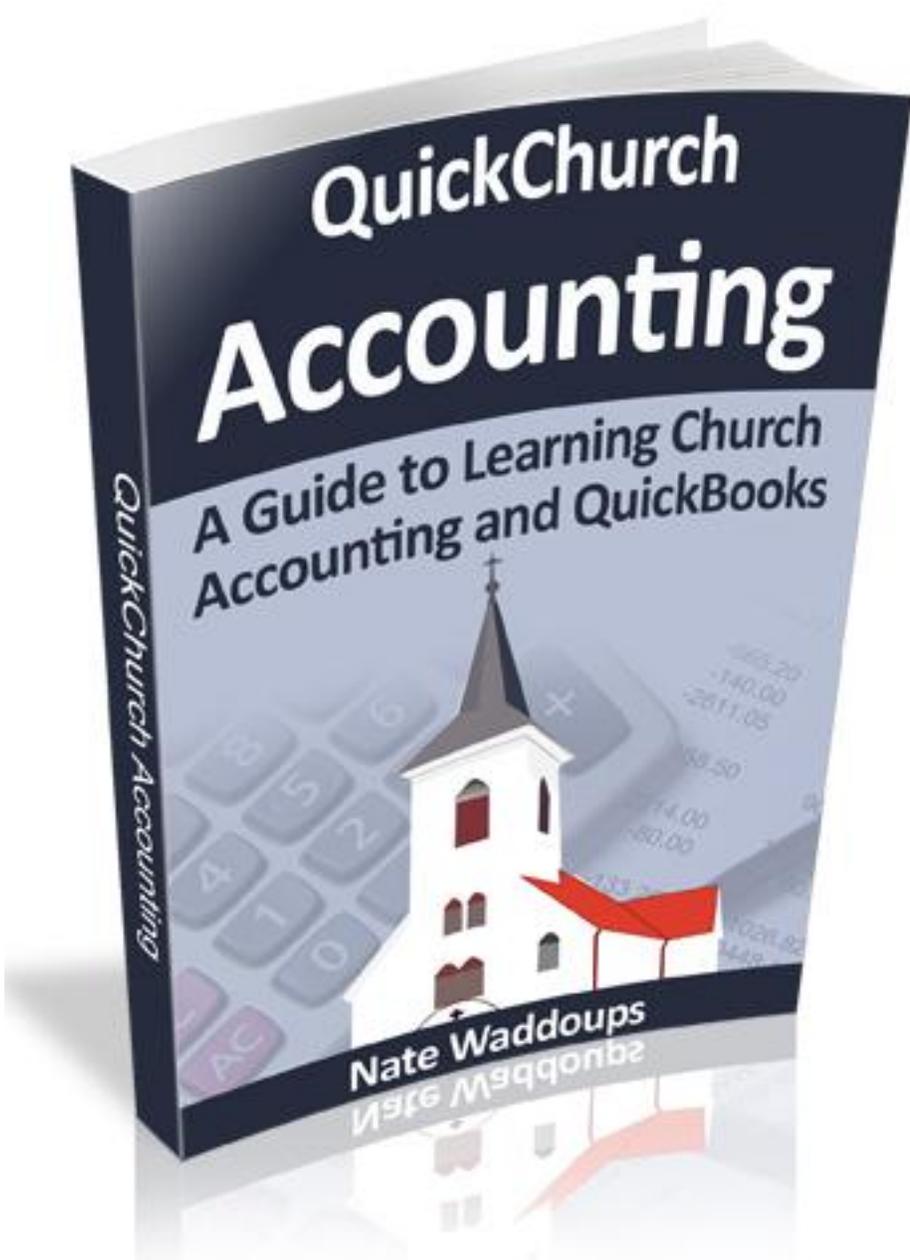


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Welcome to Class!

I look forward to helping you learn church accounting.

There are two parts to this course. The first part teaches you about journal entries, reports, debits, credits, fund accounting, and just about everything you need to know as a church accountant.

The second part of the book is designed to help you get an accounting system in place at your church. I decided to use the QuickBooks Nonprofit version because it's relatively inexpensive and easy-to-use.

Below is a detailed outline of the course (this outline is also found in the sidebar to the right). Feel free to read all the lessons in order (I'd recommend that for most people). Or just read the lessons that you need help with. Don't forget to ask questions at the end of the lesson if you have them!

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Lesson 1: So You've Been Asked to be a Church Treasurer



Your first few weeks of being a church accountant feel a lot like this.

So you've been asked to be your church treasurer. You may feel overwhelmed, especially if you don't have any experience with accounting. I can still remember when I was first called to be in charge of the finances for my church. At the time I had already earned my Bachelor's and Master's degrees in accounting and worked for one of the largest accounting firms in the world. You know what? I still felt overwhelmed.

Sometimes I think the adversary works on us to make us feel inadequate. If you are feeling similar feelings of inadequacy, then take a step back and think about these two promises from the scriptures:

Isaiah 41:10 Fear thou not; for I am with thee: be not dismayed; for I am thy God: I will strengthen thee; yea, I will help thee; yea, I will uphold thee with the right hand of my righteousness.

Philippians 4:13 I can do all things through Christ who strengtheneth me.

I can give you my personal promise that God will help you as you strive to do your best at handling your church's finances. Pray often, work hard, ask for help, and before you know it you'll be an expert at church accounting.

My goal is to help you along the way. I'll share my accounting knowledge and be here if you have any questions.

With that mindset, let's get started.

My experience teaching accounting has shown that starting with the end in mind really helps students learn accounting. Students find accounting less tedious to learn when they first see their goal, then they see that every step they are taking is moving them towards that goal.

So what are your goals as a church accountant?

Every church is a little different (even those churches within the same religion). For example, the accounting needs and goals of a Methodist church in New Hampshire will likely be slightly different than the accounting needs for a Methodist church in Virginia. The same goes for other religions (Southern Baptists, Catholics, Mormons, other Christians/Protestants, Buddhists, the Islamic religions, etc.).

Though the accounting reports may vary from church to church, they all share some common goals:

(1). Day-to-day Management Reporting: The reports that the leaders of your church need in order to make financial decisions.

(2). Year-end Financial Statements: The Statement of Activities, the Statement of Financial Position, and the Cash Flow Statement. All churches need these reports at the end of the reporting period.

(3). Year-end Donor Statements for Tax Purposes: You'll need to give the donors a list of all their contributions for the year. You may also want to issue individual contribution receipts.

If you keep these goals in mind at all times, you'll have the energy to keep moving when we start getting bogged down in debits, credits, journal entries and all the other wonderful accounting inventions. Accounting really is fun when you realize what you're doing.

End of Lesson 1

Lesson 2: The Goal(s) of Church Accounting (Catching the Vision)

In the last section, we talked about starting with the end goals in mind. The goal of a church accountant is to be able to produce management reports, financial statements, and donor statements. If you don't have any experience in accounting, then you probably have no idea what financial statements are. How can you visualize your end goal if you don't know what it is? You can't.

Getting a Visual on the Goal

Most motivational speakers will tell you that in order to achieve your goal, you need to visualize it first. Let's get a visual on our goals: the financial reports and donor statements. Note that this lesson is only meant to introduce you to these subjects and help you visualize them. In a later lesson I have much more detailed information about each of these reports.

There are three financial statements that your church will want to produce at least annually. Those statements are discussed briefly below:

(1) The Statement of Financial Position (Balance Sheet)

This statement shows the financial position of your church. It summarizes everything your church owns (the church's assets) and everything the church owes (the church's liabilities).

1st Church			
Statement of Financial Position			
As of December 31st, 20XX			
ASSETS:		LIABILITIES:	
Current Assets		Current Liabilities	
Cash	\$ 5,000	Accounts Payable	\$ 3,000
Receivables	5,000	Wages Payable	2,000
Supplies	5,000	Other Payables	1,000
Total Current Assets	15,000	Total Current Liabilities	6,000
Long Term Assets		Long Term Liabilities	
Land	50,000	Notes Payable	35,000
Building	75,000	Total Long Term Liabilities	35,000
Equipment	25,000	Total Liabilities	41,000
Less: Accum. Depreciation	(10,000)	NET ASSETS:	
Total Long Term Assets	140,000	Unrestricted	55,000
		Temporarily Restricted	10,000
		Permanently Restricted	49,000
		Total Net Assets	114,000
Total Assets	155,000	Total Liabilities and Net Assets	155,000

(2) The Statement of Activities (Income Statement)

This statement displays all the contributions your church has received and all the expenses your church has spent. It shows whether your church has a surplus this year (net income) or a deficit (net loss).

1st Church				
Statement of Activities				
For the Year Ended December 31st, 20XX				
	Unrestricted	Temp. Restricted	Perm. Restricted	Total
REVENUE:				
Contributions	50,000	5,000		55,000
Net Assets released from restrictions	3,000	(3,000)		0
Interest Income	1,000			1,000
Event Income	10,000			10,000
Endowments			10,000	10,000
Total Revenue	64,000	2,000	10,000	76,000
EXPENSES:				
Wage Expense	30,000			
Utilities	3,000			
Missionary Program	2,000			
Youth Program	3,000			
Other Program	5,000			
Admin. Expense	10,000			
Fundraising Expense	5,000			
Depreciation Expense	5,000			
Total Expenses	63,000	0	0	63,000
Change in Net Assets	1,000	2,000	10,000	13,000
Net Assets, Beginning	54,000	8,000	39,000	101,000
Net Assets, End	55,000	10,000	49,000	114,000

(3) Cash Flow Statement

The phrase, "Cash is King" is very common in the accounting world because without cash a business or a church cannot operate. The cash flow statement shows exactly how much cash your church has readily available. Church leaders use this information for budgeting and purchasing information. This statement also shows where your church's cash came from and where it has been spent.

1st Church
Statement of Cash Flows
For the Year Ended December 31st, 20XX

Cash Flow From Operating Activities

Receipts:

Contributions/Offerings 55,000

Event Receipts 21,000

Total Receipts: **76,000**

Cash Disbursements: (25,000)

Net Cash from Operating Activities: 51,000

Cash Flow from Investing Activities

Purchase of Property, Land, and Equipment (50,000)

Net Cash from investing Activities: (50,000)

Cash Flow from Financing Activities

Bank Loans 50,000

Repayment of Loans (10,000)

Net Cash Provided from Financing Activities 40,000

Net Increase in Cash 41,000

Cash at Beginning of Year 10,000

Cash at End of Year 51,000

Take some time to look over these statements. They're the reason that you're going to be undergoing the torture of studying the forthcoming lessons (no fear – I'll try to minimize said torture). All the weird things we do in accounting like debits, credits, and journal entries ultimately lead to producing these statements. The main goal of all the accounting software programs out there is to produce these statements (they're a big deal).

Remembering these Statements

As I've taught church accounting I've noticed that students have a hard time keeping the names of these statements straight. For that purpose I have decided to color code them throughout these lessons.

Statement of Financial Position =

Statement of Activities =

Cash Flow Statement = Green for Cash!

One thing that helps me keep them straight is to remember a couple of the main items on each report.

Statement of Financial Position = Assets and Liabilities

Statement of Activities = Revenues and Expenses

Cash Flow Statement = Cash

Year End Contribution Statement

One other goal worth mentioning is the year-end annual church contribution statements that your church will want to hand out to the members. The members need this form to claim a deduction on their individual taxes.

<h2 style="margin: 0;">1st Church</h2>	
<p style="margin: 0;">755 North Street Way Church City, State, Zip Code</p>	
Annual Charitable Cash Contributions	
Donor: John Doe	
Date: Jan 31 st , 20X2	
<p>This statement contains a record of voluntary contributions to 1st Church made by John Doe during the 201X year. No goods or services were provided by 1st church in return for these contributions other than intangible religious benefits.</p>	
Date	Total
22 Jan 201X	\$705.05
31 Mar 201X	\$400.03
19 May 201X	\$1,015.00
1 Dec 201X	\$290.77
Total:	\$2,410.85

Now that you know where we're going, let me show you the roadmap of how we're going to get there.
(Allow me to also introduce you to a good friend known as the Church Accounting Cycle of Doom).

End of Lesson 2

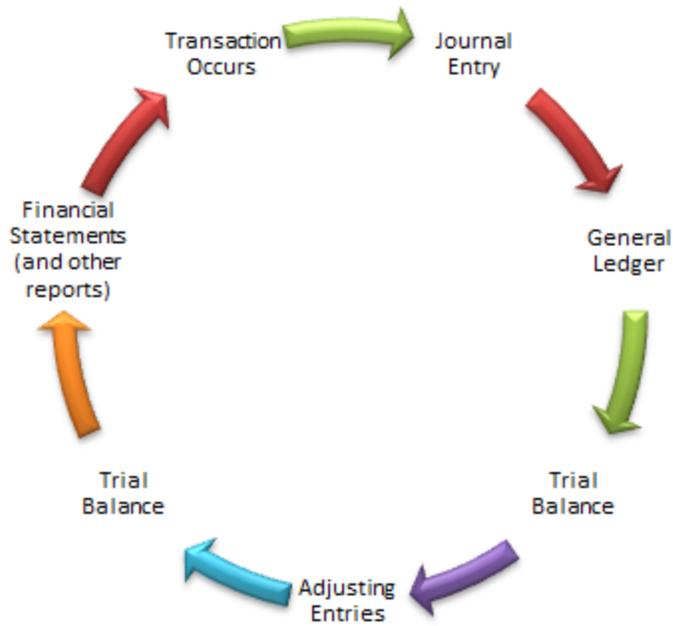
Lesson 3: The Church Accounting Cycle of Doom (Dread, Despair, Etc.)

Now that we've taken the time to visualize where we're going, let's talk about how to get there.

Let me now show you the roadmap to reach that goal. Don't get nervous if you don't recognize or understand any of the steps. We'll learn them along the way.



The above graphic may make it seem like you only have to perform accounting once and then you're done. In reality, it's a process that never ends! I created the graphic below so that you'll be able to see the endless torture you'll endure as a church accountant (Kidding of course. By the end of this book you'll probably want to go back to school to get your accounting degree because you'll be having so much fun.).



The Church Accounting Cycle of Doom

As we're going through the lessons I'll remind you about where we're at in the Church Accounting Cycle of Doom. Knowing where you're at really helps the learning process.

Now that you know about the heartache you will be suffering we might as well get started with step one in the cycle: Transactions.

End of Lesson 3

Lesson 4: Step 1 – Transactions Happen

Step 1: A Transaction Happens

After you've been in the accounting world for a while you start speaking a funny language. The word 'transaction' is part of an accountant's everyday vocabulary. Even if you've avoided becoming an accountant to this point in your life, you've probably used the word transaction. Today, we are going to take some time to really define the term and provide some common examples within the church.

In common tongue, the word 'transaction' simply means an exchange of something (usually money for goods).

In accountant tongue, the word 'transaction' refers to any event that changes the financial position of the church.

Let's look at some examples of common transactions within a church:

- A member donates tithes or offerings to the church. This is a transaction (even though they don't get any physical goods in return) because when a member donates money to the church, it changes the financial position of the church.
- The church buys anything (supplies, furniture, scriptures, hymn books, buildings, anything). When a church buys something it changes the financial position of the church, so this is also a transaction.
- Other common church transactions: receiving a loan from the bank, receiving a grant, receiving money from a fundraiser, receiving a noncash gift, and paying employees.

Okay, so now you probably have a good feel for what a transaction is.

Accountants Must Record All Transactions

In order to create financial reports and donor statements, you're going to have to record all of the transactions that happen. You record these transactions in a journal. A journal can be kept in a simple paper notebook or on the computer using Excel or in an accounting software package. Every transaction you record is called a journal entry. Now we're starting to sound like accountants. We'll learn more about journal entries in the next lesson.

Wrapping up Step 1



Today we passed through Step 1 of the Accounting Cycle of Doom (understanding transactions). Just remember that a transaction is any event that changes the finances of the church! Your job as church treasurer is to record these transactions. We'll talk about how to do that in the next lesson.

End of Lesson 4

Lesson 5: Journal Entries in the Church

In the last lesson we talked about the word transaction (Step 1 in the Church Accounting Cycle of Doom). A transaction is simply any event that changes the financial position of the church. It's an accountant's job to record these events or transactions. We record these transactions in a **journal**.

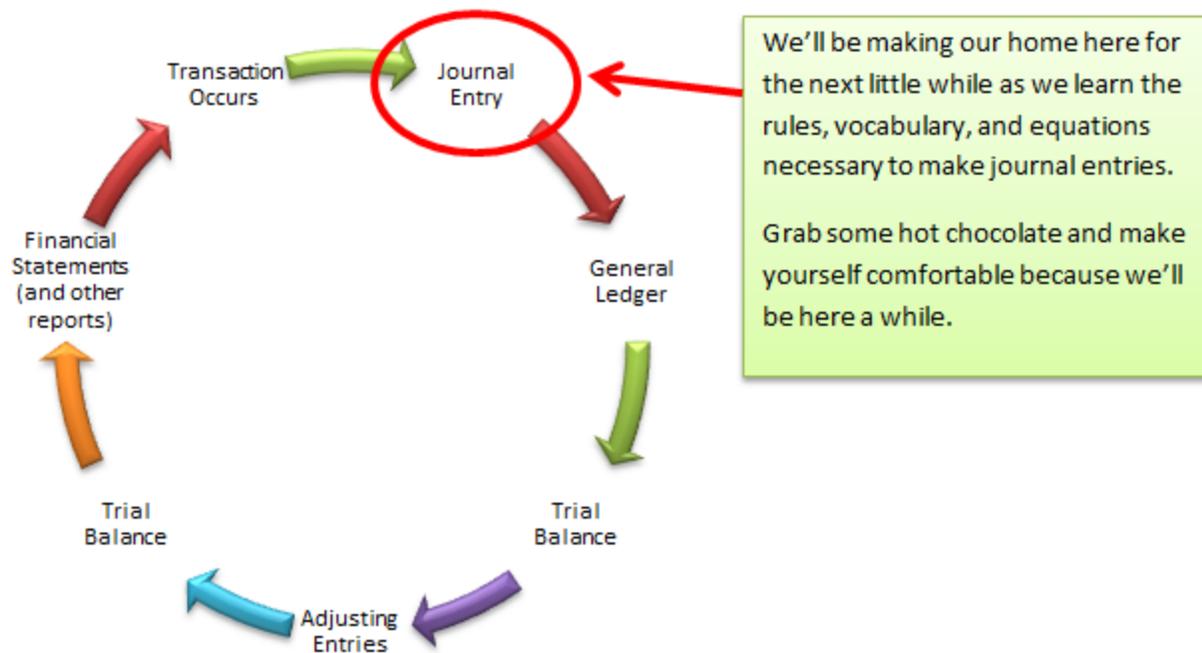
Keep in mind that a journal can simply be a paper notebook. However, nowadays most accounting journals are kept on the computer using spreadsheets or accounting software (I normally recommend accounting software, and you'll see why as you continue studying the lessons).

Up to this point things are sounding pretty simple. You're probably wondering why people like me had to go to five years of school to get a Master's degree just so we could write down transactions in a journal. The reason for all the schooling is there is a certain way that these transactions must be recorded. Why do transactions have to be recorded in a certain way, you ask? That's a discussion for another day, but for now just know that the federal government (the IRS) and other accounting agencies have rules about the way you record these transactions.

Rules, Jargon, and Equations

If you've enjoyed our time together so far, that might be about to change, so buckle up.

The proper way to record transactions in a journal involves a lot of rules and jargon (there's also an equation or two in there). For the next little while we'll be learning all the vocabulary, rules, and equations you'll need to make proper journal entries. Please hang in there as we learn all this. I promise we'll come out on the other side and be creating those financial reports.



The Church Accounting Cycle of Doom

Rule #1: Assets = Liabilities + Net Assets

In other words, all the resources (**assets**) your church owns come from borrowing money (**liabilities**) or receiving money from a contribution, grant, or fundraiser (**net assets**). This is a very important equation for you to remember as a church accountant. It will help you make the correct journal entries and it will help you prepare the financial statements. Let's talk about some of these words and then we'll look at an example.

What are Assets?

Chances are you've heard the word 'asset' before. Basically an asset is **something that the church owns** that provides value. An asset is simply a resource that the church owns. These are some common examples of church assets:

- Cash
- The church building itself and any buildings the church owns
- The land the church is built on and any other land the church owns
- Books and supplies the church owns
- Vehicles the church owns

- Pledges receivable (What??!! How can something that's owed to me be an asset? Pledges are indeed an asset. They are a resource that the church owns that will provide future benefit to the church).

What are Liabilities?

Okay, so you have down the basic idea of assets. What are liabilities then? Liabilities are what your church owes: your church's debts. These are some common examples of debt:

- Accounts Payable (money your church owes to vendors (stores) if something was purchased with a credit account)
- Mortgage Payable (money owed for purchase of buildings)
- Salary Payable (money owed to employees for work performed)

What are Net Assets?

So you've got liabilities figured out, let's talk about net assets. This concept is a little tougher to grasp. If you don't understand the concept after reading my explanation below, don't worry, just keep moving along. Net assets will make a lot more sense after you have gone through the Church Accounting Cycle a few times.

When I'm teaching accounting I like to explain this concept in the following manner. Basically, there are two ways your church receives assets (money or other resources):

- (1). Your church borrows the money (a **liability**). Or
- (2) The money can be given through the form of a donation, grant, or fundraiser (a **net asset**).

Together, these equal all of the **assets** for your church (Assets = Liabilities + Net Assets).

Side note: In the business world, accountants call net assets "owners' equity" or "stakeholders' equity". If you've ever purchased stock in a company then you are part of that company's owners' equity or net assets.

Another Way of Looking at Net Assets for the Mathematically Inclined

Let's do some basic algebra here. Our equation is Assets = Liabilities + Net Assets. Let's move liabilities over to the other side and we get the following equation:

$$\text{Assets} - \text{Liabilities} = \text{Net Assets}$$

In other words, if you subtract all your church's liabilities (everything your church owes) from all your church's assets (everything your church owns), you're left over with your church's net assets.

The word 'net' basically means everything left over. As an example, think of the 'net' income on paychecks you receive. You have your gross income and then you subtract out all the money the government takes and you're left with your 'net' income.

Yet Another Way to Look at Net Assets (The Fun Approach)

Let's pretend that as of January 1st of this year all your church's assets can be represented by three bags of gold.



It just so happens that one of those bags of gold is money borrowed from the bank. It's a liability (you have to pay it back at some point). During the year your church spends another bag of gold to pay for employees, help the poor, run the missionary program, etc. etc. After all of your church's expenses and all of its liabilities you are left with one bag of gold. That bag of gold represents your church's Net Assets.



This bag of gold was spent during the year.

This bag of gold represents all the money your church owes (your liabilities)

This bag of gold that remains represents your church's net assets.

Ugh, I'm Sick of Accounting Already. Why is this Equation Important?

Okay, let's bring this equation back in to perspective. Today, we're working on recording transactions in the journal. Let's look at how this equation helps us as church accountants.

Imagine for a second that today your church goes out and buys \$10,000 worth of comfortable, plush benches (the nice ones that don't hurt your back). You bought the benches using a credit account at the local furniture shop. You're the church accountant; it's your job to record this transaction. You open up your "accounting journal" and write the following note:

We bought \$10,000 worth of benches today. Had a great time testing out the benches with Pastor John. We bought the benches on credit.

Let's look at how this journal entry affects the accounting equation. The benches themselves are now an asset of the church. The church also now owes \$10,000 in liabilities to the local furniture shop because you bought the benches using your credit line with the store. So \$10,000 (asset) = \$10,000 (liability) + \$0 Net Assets.

The equation balances. The equation will always balance as long as you're doing your bookkeeping correctly. This equation is important because it helps prevent errors. It's also important because the financial reports we will be generating later on are categorized according to assets, liabilities, and net assets. Take a look at the statement of financial position below and you should be able to clearly see the accounting equation we're discussing.

1st Church Statement of Financial Position As of December 31st, 20XX			
ASSETS:		LIABILITIES:	
Benches	\$ 10,000	Accounts Payable	\$ 10,000
		NET ASSETS:	
		Unrestricted	0
		Temporarily Restricted	0
		Permanently Restricted	0
Total Assets	10,000	Total Liabilities and Net Assets	10,000

That's with just one transaction. Now look at this again assuming we've done many transactions:

1st Church Statement of Financial Position As of December 31st, 20XX			
ASSETS:		LIABILITIES:	
Current Assets		Current Liabilities	
Cash	\$ 5,000	Accounts Payable	\$ 3,000
Receivables	5,000	Wages Payable	2,000
Supplies	5,000	Other Payables	1,000
Total Current Assets	15,000	Total Current Liabilities	6,000
Long Term Assets		Long Term Liabilities	
Land	50,000	Notes Payable	35,000
Building	75,000	Total Long Term Liabilities	35,000
Equipment	25,000	Total Liabilities	41,000
Less: Accum. Depreciation	(10,000)		
Total Long Term Assets	140,000		
		NET ASSETS:	
		Unrestricted	55,000
		Temporarily Restricted	10,000
		Permanently Restricted	49,000
		Total Net Assets	114,000
Total Assets	155,000	Total Liabilities and Net Assets	155,000

This is what a typical statement of financial position will look like. You can see that the total dollar value of assets (marked in red above) is equal to the total dollar value of the liabilities and net assets (marked in green above). If you can understand this accounting equation, then you've got the statement of financial position under control!

In Review

We started out the day just itching to make some journal entries. However, we soon found out that there are some pesky rules, vocabulary, and equations that we have to learn in order to properly record transactions (make journal entries). We learned the first rule of accounting: Assets must always equal Liabilities + Net Assets. We learned the definition of assets (the stuff the church owns), the definition of liabilities (the stuff the church owes), and we learned the definition of net assets (total assets minus total liabilities).

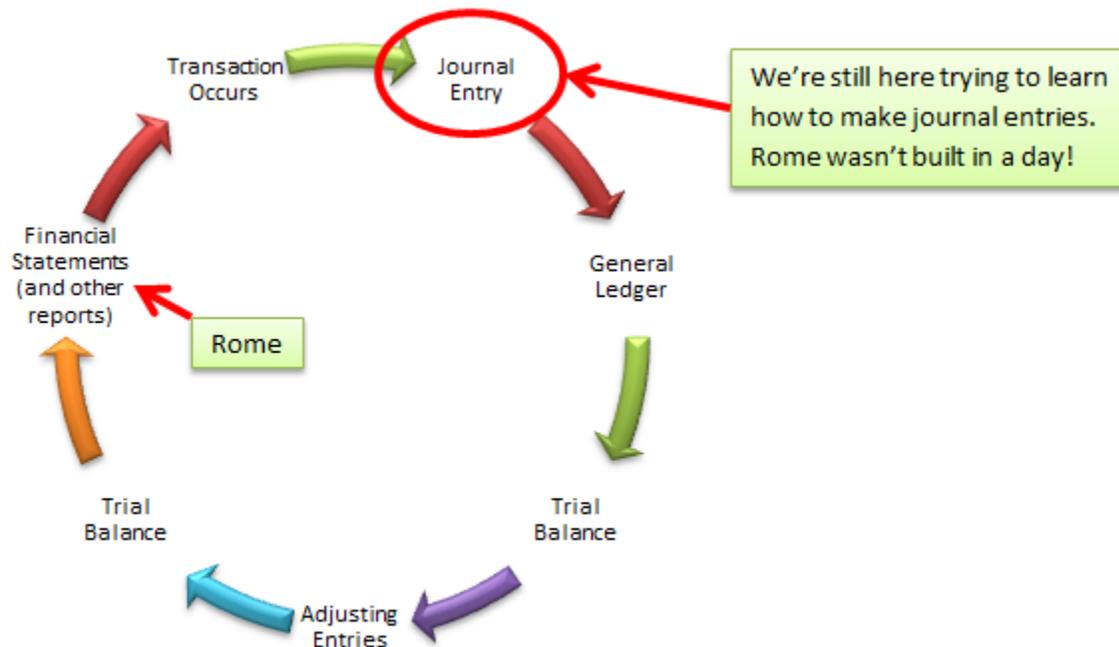
We're still a little fuzzy about what net assets are, but that's okay because we had a great day buying \$10,000 worth of benches with Pastor John.

In the next lesson, our quest to create journal entries continues. We'll be learning about debits and credits.

End of Lesson 5

Lesson 6: Debits and Credits

Today, we'll be learning about debits and credits. I know you're antsy to get on with things, but let's take a second to see where we are in the Church Accounting Cycle.



The Church Accounting Cycle of Doom

In the last lesson we learned the infamous accounting equation: $\text{Assets} = \text{Liabilities} + \text{Net Assets}$. We'll be playing around more with that today as we learn about debits and credits.

If you remember in our last lesson, you and Pastor John went out to buy some benches (\$10,000 worth of benches to be exact). You made your first journal entry, pictured below:

We bought \$10,000 worth of benches today. Had a great time testing out the benches with Pastor John.

This is a great journal entry, but unfortunately you're going to have to modify it a bit so it's up to snuff in the accounting world.

Side Note: It's true that you could probably get away with simply making all of your journal entries like the one above. However, if you ever get audited or if you ever want to create a proper financial report you'll be paying an accountant like me a boatload of money to read through all your journal entries and put them in the appropriate format. I'm not complaining because I appreciate the work, but you might

be (complaining that is) once you see how much I charge! As a rule of thumb, you should never pay a Certified Public Accountant (CPA) to perform the basic accounting functions that you can perform yourself. If you can't do it yourself, then hire a bookkeeper who can. Bookkeepers are very inexpensive when compared to CPAs. Hiring a part-time bookkeeper (or doing some of these basic accounting functions yourself) can save your church a lot of money.

More Journal Entry Rules

What follows is a set of rules that we'll be learning about in the next few lessons. If this is your first time dealing with accounting, then these rules probably look like a bunch of gobbledygook to you.

1. Rule: Debits are on the left. Credits are the right
2. Rule: Debits = Credits
3. Rule: Assets are increased with a debit and decreased with a credit.
4. Rule: Liabilities are increased with a credit and decreased with a debit (the opposite of assets)
5. Rule: Net assets are increased with a credit and decreased with a debit (the same as liabilities).

Understanding These Rules

To understand these rules, we're going to look at the correct journal entry for you and Pastor John purchasing \$10,000 worth of benches. Now we're going to say that you purchased these benches with cash, not on credit.

Furniture (Asset)	\$10,000
Cash (Asset)	\$10,000
1/11/20X1 Pastor John and I purchased some benches for the church.	

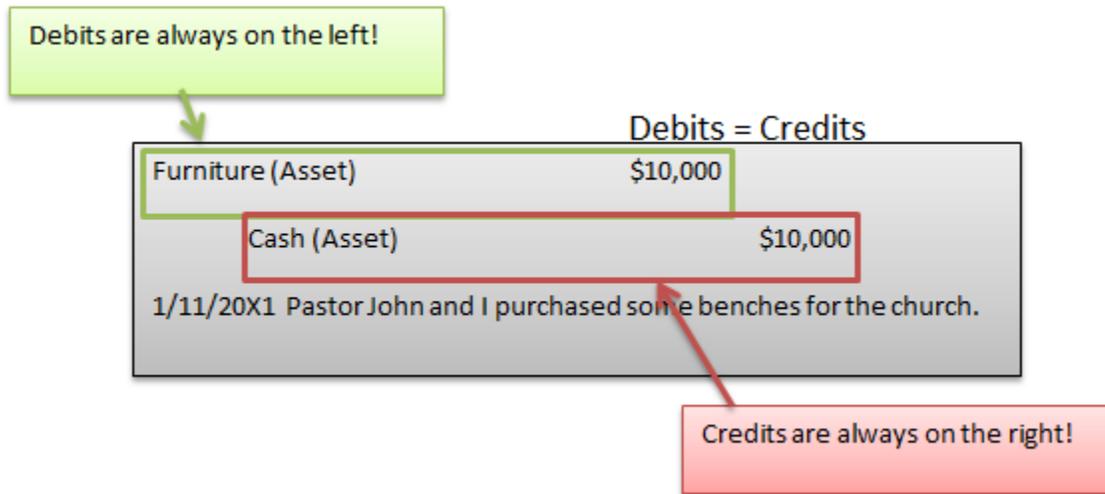
\$10,000 worth of furniture is coming in on the left and \$10,000 worth of cash is going out on the right.

What are debits and credits anyway?

A debit is simply a journal entry that is placed on the LEFT side of the journal (see picture of debit and credit below under rule 1). A credit is simply a journal entry that is placed on the RIGHT side of the journal. Don't think of debits or credits as increases or decreases for now (that just gets too confusing). Simply think of them as left (debit) and right (credit).

Did you know? In Latin, the word debit means left and word credit means right! That's not true at all; I'm just trying to get you thinking the correct way.

1. Rule: Debits are on the left and credits are on the right.



In the above journal entry, furniture is debited (it's on the left) and cash is credited (it's a little farther to the right). Just remember the general rule: debits are on the left and credits are on the right.

2. Rule: Debits = Credits

Any time a transaction occurs there will always be a debit journal entry and a credit journal entry. The rule is the amount of money you debit must equal the amount of money you credit. This helps accountants avoid mistakes and it also helps keep our accounting equation in balance: Assets = Liabilities + Net Assets (more on this later).

Debits = Credits	
Furniture (Asset)	\$10,000
Cash (Asset)	\$10,000
1/11/20X1 Pastor John and I purchased some benches for the church.	

3. Rule: Assets are increased with a debit and decreased with a credit.

How did I know to debit furniture (place it on the left) and credit cash (place it on the right)???? The answer is I have memorized the accounting rule that when you receive an asset you debit the asset account, when you get rid of an asset you credit the asset account.

To further understand this concept, let's pretend that you are keeping track of all of your church's cash using a T account (pictured below). It's called a T account because it looks like a T. Any time you receive cash, the rule is that you must place the amount received on the left side of the T Account. Any time you

send cash out, the rule is that you must place the amount spent on the right side of the account. It's just a rule that you're going to have to follow!

Church Cash	
	Debits Credits
Beg. Balance	100,000 10,000
Current Balance	90,000

Credits are still on the right!

In the above T account your church started out with \$100,000 of cash. Your church spent \$10,000 worth of cash on benches. So your church credited the cash account for \$10,000. Your remaining cash balance is a debit balance of \$90,000.

So that explains the cash account, but what about the furniture account?

Church Furniture	
	Debits Credits
Beg. Balance	0
	10,000
Current Balance	10,000

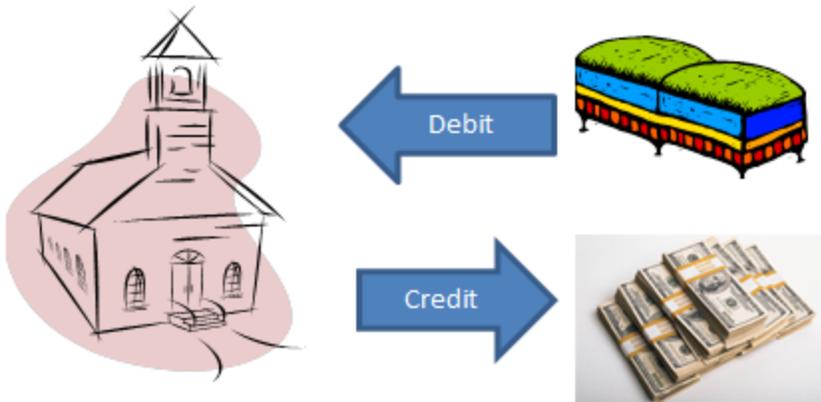
Debits are still on the left!

Remember our rule states that assets are increased with a debit. In other words, when you receive an asset, you debit the appropriate asset account. Furniture is definitely an asset. In the above T account your church started out with \$0 worth of furniture. You and Pastor John purchased \$10,000 worth of furniture so you debit the church furniture account for \$10,000. Your current furniture balance is a debit balance of \$10,000.

Reviewing the Process

Let's take a quick look at what's really happening here.

Step 1: Your church purchases \$10,000 worth of benches with cash.



Step 2: You make this entry in the journal.

Furniture (Asset)	\$10,000
Cash (Asset)	\$10,000
1/11/20X1 Pastor John and I purchased some benches for the church.	

Step 3: Your T Accounts (also known as ledgers or ledger accounts) get updated.

Church Cash		Church Furniture	
	Debits	Credits	
Beg. Balance	100,000		Beg. Balance
		10,000	0
			10,000
Current Balance	90,000		Current Balance
			10,000

We're jumping ahead a little here with these ledgers (T Accounts). They're actually the next step in the Church Accounting Cycle. I wanted to show them to you here though so you could understand why debits are on the left and credits are on the right.

Fast Forward

Hopefully you're starting to see how this whole accounting process works. It's pretty exciting! A transaction occurs and you record that transaction in a journal. Next, all the information from the journal is summed up in ledgers. Finally, all the information from these ledgers is summarized and then

placed on the financial reports that you'll be giving to banks, church leaders, or anyone who wants to see the reports.

Why Church Accounting Software is Helpful

If you have some accounting software, then all you have to do is enter the journal transaction and the ledgers automatically get updated. In addition, with the click of a button the software will take the numbers from the ledgers and generate the financial reports you're hoping to produce. If you can figure out how to do these journal entries correctly, your church's financial records will be in good shape. In the next section we'll continue to learn how to do more journal entries.

Concluding Today's Lesson

Today we learned that to make a proper journal entry we must follow certain rules. We learned that debits are on the left and credits are on the right. Always. We learned that the amount of money debited (placed on the left) must equal the amount of money credited (placed on the right). We used T-accounts or ledgers to show that the amount of assets your church owns is always increased with a debit to the left side of the ledger and always decreased with a credit to the right side of the ledger.

In the next lesson we'll review ledgers and we'll learn the rules for liabilities and net assets.

End of Lesson 6

Lesson 7: More on Journal Entries

In the last section, you got introduced to journal entries. We learned that debits are always on the left and credits are always on the right. We learned that debits must always equal credits. In other words if you make a left-handed journal entry, then you've got to make a right-handed journal entry.

Side Note: Most historians credit the invention of debits and credits to Frater Pacioli (an Italian born in the 1400's). However, the historians must have missed the following scripture found in Mathew 6:3: "But when thou doest alms, let not thy left hand (debits) know what thy right hand (credits) doeth." Keep in mind that Mathew was an accountant (tax collector)!

In the previous less we also learned that assets are increased with a debit and decreased with a credit. Today we'll talk some more about increases and decreases in assets, liabilities, and net assets.

In order to understand these increases and decreases we'll need to look at ledgers again (we briefly mentioned them in the last lesson).

Ledgers

In the last section you were briefly introduced to ledgers (pictured below). Basically a ledger is just a tool that helps you keep track of the balance of your individual accounts (it's a lot like a checkbook to be honest). Below is an illustration of our accounting equation with corresponding ledger.

$$\text{Assets} = \text{Liabilities} + \text{Net Assets}$$

	Assets	
	Debits	Credits
Beg. Balance	100,000	10,000
Current Balance	90,000	

	Liabilities	
	Debits	Credits
Beg. Balance		45,000
Current Balance		45,000

	Net Assets	
	Debits	Credits
Beg. Balance		45,000
Current Balance		45,000

As you look at the above ledgers, hopefully you can see that assets usually have a debit (left-handed) balance. Liabilities and net assets usually have a credit (right-handed) balance. Below I have a copy of the rules we talked about in the last lesson. The truth is after a while you don't even think about the rules because they become second nature (with some practice you'll get there).

Rules:

1. Assets are increased with a debit and decreased with a credit.
2. Liabilities are increased with a credit and decreased with a debit.
3. Net assets are increased with a credit and decreased with a debit.

Let's look at some examples and apply these rules:

Example #1 – Church Buys a Van

The church purchases a van (asset) for \$20,000 by borrowing money from a local bank (a liability).

A question you can ask to help yourself with these journal entries is, "What is the church receiving? What is the church giving?" The church is receiving a van that cost \$20,000. A van is an asset. The church isn't giving up any assets in this example, but it now owes the bank \$20,000. Money owed to the bank is a liability.

So you have an increase in assets (the van) and also an increase in liabilities (the debt owed to the bank). From our rules we know that an increase in an asset means a debit or left-side entry (Rule #1 above). We also know that an increase in a liability means a credit or right-side entry (Rule #2 above). That's good news because debits must always equal credits! Here's what the journal entry would look like.

Assets-Van	\$20,000
Liabilities-Bank	\$20,000
The church purchased a van by borrowing money from the bank.	

Example #2 – Church Pays off Debt

Remember the \$20,000 van your church purchased on credit? This month your church decides to pay the bank \$10,000 of the \$20,000 it owes. Your church is always very responsible about its debts.

In this situation your church is giving up \$10,000 in cash so assets are decreasing by \$10,000. Your church is also getting rid of \$10,000 worth of debt so liabilities are also decreasing by \$10,000. According to the rules we know that a decrease in an asset is a **credit** (Rule #1) and a decrease in a liability is a **debit** (Rule #2). Phew! Debits equal credits once again. We are safe.

Liabilities-Bank	\$10,000
Assets-Cash	\$10,000
The church paid off \$10,000 worth of its debt.	

Notice that we always place the debit on top in the journal entry. This is just something that accountants do (no real reason or rhyme to it).

Example #3 – Church Buys a Computer

Your church decides to buy three new computers and an iPad (your church is technologically savvy). The total cost is \$5,000 and you pay with cash.

In this situation you are increasing an asset (computers) and decreasing an asset (cash). An increase to an asset means a debit (Rule #1) and a decrease to an asset means a credit (Rule #1). Once again debits equal credits (hopefully you are starting to see a trend here).

Asset-Computers	\$5,000
Assets-Cash	\$5,000
The church purchased three new computers and an iPad.	

Watch an Accounting Miracle Unfold Before Your Eyes!

Remember at the beginning of this lesson when I showed you the following picture?

$$\text{Assets} = \text{Liabilities} + \text{Net Assets}$$

Assets		
	Debits	Credits
Beg. Balance	100,000	10,000
Current Balance	90,000	

Liabilities		
	Debits	Credits
Beg. Balance		45,000
Current Balance		45,000

Net Assets		
	Debits	Credits
Beg. Balance		45,000
Current Balance		45,000

Hopefully you can see that the current balance of total assets (\$90k) is equal to the current balance of liabilities (\$45k) + net assets (\$45k).

Now, look what happens when I add the three transactions that took place in this lesson. Prepare to be amazed.

$$\text{Assets} = \text{Liabilities} + \text{Net Asset}$$

Assets			Liabilities			Net Assets		
	Debits	Credits		Debits	Credits		Debits	Credits
Beg. Balance	100,000		Beg. Balance		45,000	Beg. Balance		45,000
#1	20,000	10,000	#2	10,000	20,000 #1			
#3	5,000	10,000 #2						
		5,000 #3						
Current Balance	100,000		Current Balance		55,000	Current Balance		45,000

If you follow all the rules for making correct journal entries, then the accounting equation will stay in balance (\$100k) = (\$55k) + (\$45k). This perfect symmetry and balance has converted many people to accounting. If you find desires swelling in you to become an accountant, do not resist them.

Conclusion/Review

Today you learned about the appropriate debits and credits needed to increase and decrease assets, liabilities, and net assets. We looked at some examples of how this all works. The rules are listed below:

1. Assets are increased with a debit and decreased with a credit.
2. Liabilities are increased with a credit and decreased with a debit.
3. Net assets are increased with a credit and decreased with a debit.

In the next section we'll get some more practice with these rules and we'll also look at how to do journal entries for revenues, expenses, and net assets.

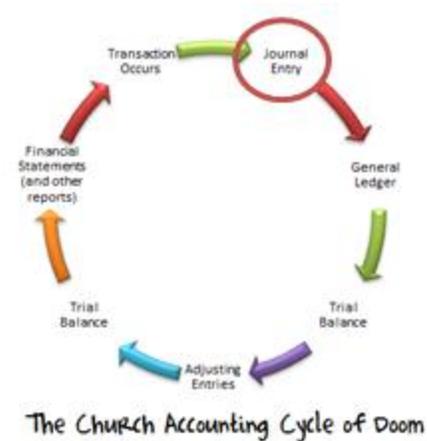
End of Lesson 7

Lesson 8: Revenues and Expenses Journal Entries

In the last section we learned how to make the journal entries for asset and liability transactions. Now, we'll work on how to make the journal entries for revenues (contributions), expenses, and net assets.

In the previous section we learned these rules:

1. Assets are increased with a debit and decreased with a credit.
2. Liabilities are increased with a credit and decreased with a debit.
3. Net assets are increased with a credit and decreased with a debit.



These rules are helpful for a large variety of transactions, but what about transactions that include church contributions or church expenses? Here are three new rules:

1. Revenues are increased with a credit and decreased with a debit.
2. Expenses are increased with a debit and decreased with a credit.
3. At the end of every year all revenues and expenses are closed out into your church's net assets account. Revenue and expense accounts are considered temporary accounts (more on this in a second).

***Note:** It's good to memorize these rules, but there's no penalty for putting them on a sticky note next to your computer. I know it's a lot to remember, so refer back as often as needed as you're doing your church's accounting. If you have accounting software, it will help you remember these rules too (in some cases accounting software will automatically apply these rules for you—more on this in Part 2 of the book where I cover using QuickBooks software for church accounting).

Example #1 – Your Church Pays Rent

Let's say that your church is renting a building. At the end of the month, your church pays \$1,000 cash for that month's rent. Rent is an expense and we're increasing our expense account when we pay for rent, so we'll debit rent (Rule #5 above). Cash is leaving the church so we are decreasing an asset. When we decrease an asset we credit the account (Rule #1). Debits equal credits!

Rent-Expense	\$1,000	
		Assets-Cash
		\$1,000
The church paid the rent for the month of January.		

***Note:** In the above example I named the expense account “Rent-Expense” and I named the cash account “Assets-Cash.” There are no specific rules about how each account should be named. The only guidelines are to be descriptive and consistent. If you call it “Rent-Expense” in your January journal entry, then make sure you call it “Rent-Expense” in your February journal entry as well.

Example #2 – Your Church Receives \$10,000 in Contributions (Tithes and Offerings)

After your compelling sermon, members of your church offer \$10,000 in tithes and offerings. You’re increasing an asset, so you’ll debit the cash account (Rule #1). You’re also increasing your church’s revenues (more on revenues below) so you’ll credit the revenue account (Rule #4).

Assets-Cash	\$10,000	
		Contributions-Revenue
		\$10,000
The church received \$10,000 in tithes and offerings on Sunday.		

What is Revenue?

In a normal business, revenue is the word used that describes the amount of money that a company receives for selling its products. The word revenue and sales are used interchangeably in a for-profit business. However, your church isn’t necessarily selling physical items like a for-profit business does. **For a church, revenue includes all the contributions given and pledged.** It also includes the money received from fundraisers, grants, day care, or any other services or goods your church might offer.

Common revenue accounts include contribution revenue, pledge revenue, and fundraiser revenue.

What are Expenses?

Expenses are really defined as any costs that the church incurs. Common examples of church expenses include rent expense, wage expense, depreciation expense, utilities, and payments to suppliers.

More Examples

Example #3 – Your Church Receives Pledges for \$5,000

This is one of the trickier examples. When a church receives a pledge (a promise to give money) from one of its donors, it is indeed receiving an asset. It's an asset because it is something that the church owns and it will provide future benefit to the church.

When your church receives this \$5,000 pledge, assets are increased. This means that you will debit the asset account (Rule #1).

Any time your church receives a pledge from a member, revenue is also increased. To increase revenue, you credit the revenue account (Rule #4).

Here's the journal entry at the time the pledge is received:

Assets-Pledges Receivable	\$5,000	
		Contributions-Revenue
		\$5,000
The church received \$5,000 in written pledges.		

***Note-** The Pledges Receivable account listed above is an asset account. These pledges receivable are not something that you can physically touch like you can with most assets. For this reason, they are considered an intangible asset. It's still worth recording these receivables though because church leaders find it very useful to know how much money has been pledged to the church.

Now, let's talk about what happens when your church receives the cash for the pledge. The church is receiving cash (an asset). Increasing an asset requires a debit (Rule #1). In exchange for the cash, the church is giving up an intangible asset (pledges receivable). When you decrease an asset account, you credit that account (Rule #1).

Assets-Cash	\$5,000	
		Assets-Pledges Receivable
		\$5,000
The church received \$5,000 in cash for the pledges receivable.		

In the above example the church is receiving cash (an asset). The church is losing another asset (the pledges).

Example #4 – Paying for Supplies on Credit

Let's say that in January of this year your church buys \$1,000 worth of supplies (paper, ink cartridges, pens, staplers, etc.) on a credit account from a local shop. We'll classify this purchase of supplies as an

expense. To increase expenses you debit the appropriate expense account (Rule #5). Your church hasn't given up any cash yet because you purchased the supplies on a credit account. Your church has a new liability (you increase liabilities with a credit – Rule #2).

Expense-Supplies	\$1,000
Liab.-Accounts Payable	\$1,000
The church purchased \$1,000 worth of supplies on credit.	

Let's pretend that in February your church pays off the \$1,000 owed. You give the local shop \$1,000 cash. Reducing an asset means a credit to that asset account (Rule #1).

You're also getting rid of your debt (liability) to the local shop. Reducing a liability means debiting that liability account (Rule #2).

Liab.-Accounts Payable	\$1,000
Asset-Cash	\$1,000
The church paid off the \$1,000 liability with cash.	

That ends our examples for the time being. If you're looking for the proper journal entry for a certain transaction that hasn't been covered, just leave a comment below and we'll see what we can do. There are so many different types of transactions that it would be impossible to cover them all here.

Conclusion

Today we learned how to make the proper journal entries for revenues and expenses. In the next section we'll look at what happens to these revenues and expenses at the end of the year. We'll also learn about closing journal entries and temporary accounts.

Don't get overwhelmed. Just keep practicing! Reread the last couple of lessons if you have to (no shame in that).

End of Lesson 8

Lesson 9: Closing Journal Entries and Temporary Accounts

In the last lesson we talked about how to make the proper journal entries for revenues and expenses. In this lesson you'll learn that revenues and expenses are actually temporary accounts that require a journal entry to be closed out at the end of every year.

***Note:** Most accounting software programs will perform all the closing journal entries for you. I still recommend you read this lesson so you know what the accounting software is doing. I especially recommend you read the section entitled **Net Assets (Keeper of Net Income)**.

Temporary Accounts

Let's talk a little bit more about these temporary revenue and expense accounts. The statement of activities (we talked about this statement in Lesson 2 "Catching the Vision") that your church generates at the end of the year will have all the revenues and expenses listed for the year. Each year this statement starts over. This means that each year your revenues and expenses start back over at zero (a clean slate, if you will).

This is very different than the statement of financial position (also discussed in Lesson 2) generated at the end of each year. This statement of financial position contains running balances that are never reset. For example, if your church bought land 25 years ago for \$50,000, this will still be reflected on the statement of financial position. If your church bought \$25,000 of land this year, then the \$25,000 would be added to the \$50,000 on the statement of financial position.

In order to start over every year, all revenues and expenses are closed out. Let me show you how this is done.

Example of Closing Out Revenues and Expenses

Let's pretend that your church had \$100,000 worth of contribution revenue and \$50,000 worth of expenses for the year. Here's what the closing journal entry would look like.

Contribution Revenue	\$100,000
Expenses for the Year	\$50,000
Net Income	\$50,000

Closing out the revenue and expense accounts for the year.

		Contrib. Revenue	
		Debits	Credits
Beg. Balance			0
			10,000
			90,000
		100,000	
Current Balance			0

This journal entry zeroes out or closes the revenue account for the year.

When you decrease a revenue account you debit the account (according to the rules we learned in the last few lessons). Because we are closing out the account, we are in essence getting rid of all revenues for the year (so we debit them – opposite of what we did with them all year). We'll debit Contribution Revenue for \$100,000.

When we get rid of an expense we credit the account (again, this comes from the rules we learned earlier). We'll credit expenses for \$50,000.

This leaves a difference of \$50,000. That difference is your church's net income for the year. Makes sense right? Revenues minus expenses equals net income.

Net Assets (Keeper of Net Income)

Finally, we get to an example of a journal transaction with net assets. When your church has more revenues (incoming cash) than expenses (outgoing cash) for the year, then your church's net income has increased. When your church has more expenses (outgoing cash) than revenues (incoming cash) your church's net income has decreased.

Eventually the net income account is also closed out (because it's on the Statement of Activities, it's a temporary account that must be closed). Let's take a look at the journal transaction that closes out net income.

Net Income	\$50,000
Net Assets	\$50,000
Closing out Net Income	

The net income account is closed out and set back to zero, but not to worry – the information is safely stored in an account called Net Assets. This also keeps our accounting equation (Assets = Liabilities + Net Assets) in perfect balance.

More on Net Assets

Hopefully the example above helps you understand a little bit more about the nature of net assets. Here’s an accounting equation that might help clarify.

Net Assets at the beginning of the year + Net Income for the year = Net Assets at the end of the year.

Or, stated a bit differently:

Net assets at the beginning of the year + All Revenues for the year – All Expenses for the year = Net assets at the end of the year.

Stated in words, the net asset account is made up of all the net income your church has generated over the years. Let’s take a look at an example of what I’m talking about.

In the first year of its existence, 1st Church starts out with zero net assets. However, during the first year 1st Church receives \$50,000 worth of contributions and only spends \$20,000 for expenses. The net income or “profit” for the year was \$30,000. This means at the end of year 1 the balance in Net Assets for 1st Church is \$30,000.

In the second year 1st Church has a net income of \$30,000. In the third year 1st Church actually has a net loss of \$40,000 (it spent more than it made that year). This is all reflected in the net asset account (pictured below).

Net Assets		
Beg. Balance	Debits	Credits
		0
Year 1		30,000
Year 2		30,000
Year 3	40,000	
Current Balance		20,000

The net assets account is made up of all the income your church has generated over the years.

Conclusion

Today we learned about closing out our revenue and expense accounts. We also learned that the statement of activities is reset to zero every year. Finally, we learned that the net asset account keeps track of all the income the church generates over the years. In the next section we'll learn about ledgers (the next phase in the church accounting cycle).

Side Note: It's probably worth mentioning that church accounting software will close these accounts out for you. I still think you should know what the accounting software is doing, but if you have software, then you won't have to close out revenues and expenses to net assets at the end of the year because the software does it for you automatically.

End of Lesson 9

Lesson 10: Ledgers, Ledgers, Ledgers

Today we're going to review what we've learned about general ledgers (T-accounts) and expand that knowledge a bit.

I know we've already covered ledgers in some detail in previous lessons. I showed ledgers to you in the journal entry section of the book so that you could see where the information from the journal entry goes. All that being said, I want to take the time today to discuss ledgers a little bit more so you can see how the information from the journal entries is copied to the general ledgers.

We got kind of bogged down in the last few lessons learning how to make proper journal entries (debits and credits). The truth is those lessons were only meant to be an introduction to the topic. There are many different types of journal entries that were not covered.

That's the bad news. The good news is that we've already covered ledgers in some depth so you shouldn't have too much trouble with today's lesson.

Let's review where we're at in the church accounting cycle.



The Church Accounting Cycle of Doom

If you found the last few lessons a bit heavy, then you'll be happy to know that this lesson is pretty simple. Once you understand the basics of journal entries, accounting gets a lot easier.

What is a General Ledger?

A general ledger is simply a T-account that keeps track of the balance of that account. Pictured below is the general ledger for cash.

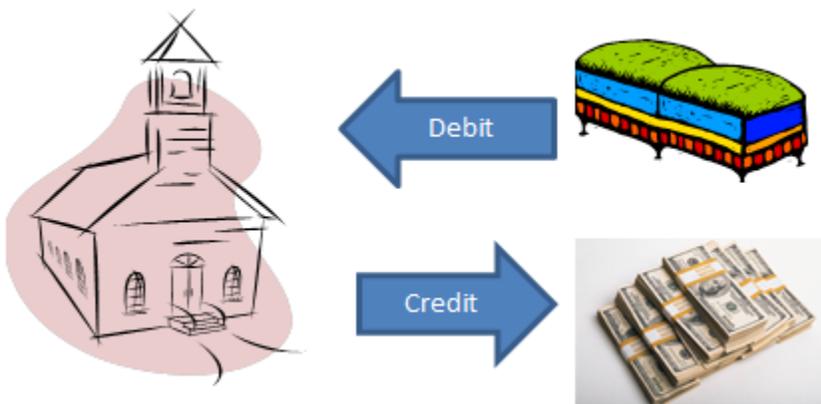
Cash		
	Debits	Credits
Beg. Balance	100,000	
		10,000
Current Balance	90,000	

The purpose of these general ledgers is to have an easy way to keep track of the dollar value of each of your accounts (common general ledger accounts include cash, equipment, liabilities, pledges receivable, supplies, revenues, and expenses). At the end of the year all these balances will show up on the financial statements that your church wants to produce.

Let's Look at an Example

In a previous lesson you and Pastor John purchased some benches for \$10,000 using cash (or a check).

Step 1: Recognize a transaction has occurred.



Step 2: Record the transaction in an accounting journal.

Furniture (Asset)	\$10,000
Cash (Asset)	\$10,000
1/11/20X1 Pastor John and I purchased some benches for the church.	

Step 3: Update the general ledgers.

Church Furniture		Church Cash	
	Debits	Credits	
Beg. Balance	0		Beg. Balance
	10,000		100,000
			10,000
Current Balance	10,000		Current Balance
			90,000

Pretty simple right? The truth is ledgers are a simple, but powerful tool. They help keep track of all your church’s assets, liabilities, revenues, expenses, and net assets. You can keep track of these ledgers on paper, using excel, or by using a church accounting software program. If you’re using an accounting software program, then all you have to do is enter the journal entry and the program updates the ledgers for you! It’s a nice time-saver and it helps prevent errors.

More Examples

Before we move on to the trial balance phase of the Church Accounting Cycle, let’s take a look at some more examples. Below are five journal entries found in your church’s journal. Let’s update the general ledgers! This is an accountant’s idea of fun.

1st Church Accounting Journal

Assets-Van	\$20,000
------------	----------

Liabilities-Bank	\$20,000
------------------	----------

The church purchased a van by borrowing money from the bank.

Liabilities-Bank	\$20,000
------------------	----------

Assets-Cash	\$20,000
-------------	----------

The church paid off \$20,000 worth of debt.

Asset-Computers	\$5,000
-----------------	---------

Assets-Cash	\$5,000
-------------	---------

The church purchased three new computers and an iPad.

Rent-Expense	\$1,000
--------------	---------

Assets-Cash	\$1,000
-------------	---------

The church paid the rent for the month of January.

Assets-Cash	\$10,000
-------------	----------

Contributions-Revenue	\$10,000
-----------------------	----------

The church received \$10,000 in tithes and offerings on Sunday.

Ledger Update for Journal Entry #1

Assets-Van		
	Debits	Credits
Beg. Balance	0	
#1	20,000	
Current Balance	20,000	

Liabilities		
	Debits	Credits
Beg. Balance		0
		20,000 #1
Current Balance		20,000

Ledger Update for Journal Entry #2

Cash		
	Debits	Credits
Beg. Balance	100,000	
		20,000 #2
Current Balance	80,000	

Liabilities		
	Debits	Credits
Beg. Balance		0
#2	20,000	
		20,000 #1
Current Balance		0

Ledger Update for Journal Entry #3

Cash		
	Debits	Credits
Beg. Balance	100,000	
		20,000 #2
		5,000 #3
Current Balance	75,000	

Asset Computers		
	Debits	Credits
Beg. Balance	0	
#3	5,000	
Current Balance	5,000	

Ledger Update for Journal Entry #4

Cash	
	Debits Credits
Beg. Balance	100,000
	20,000 #2
	5,000 #3
	1,000 #4
Current Balance	74,000

Rent Expense	
	Debits Credits
Beg. Balance	0
#4	1,000
Current Balance	1,000

Ledger Update for Journal Entry #5

Cash	
	Debits Credits
Beg. Balance	100,000
	20,000 #2
	5,000 #3
	1,000 #4
#5	10,000
Current Balance	84,000

Contrib. Revenue	
	Debits Credits
Beg. Balance	0
	10,000 #5
Current Balance	10,000

As an accountant, I really find this process of posting to the ledgers a thing of beauty. I mean, imagine if your church leadership committee asked for the current cash balance. All you'd have to do is pull up your cash general ledger account and you could tell them everything they wanted to know! If they wanted to know where all the cash had been spent, you could trace it back from the cash general ledger to your individual journal entries. If you *really* wanted to impress the church leadership and any auditors, you could keep all the receipts and other documentations filed according to their related journal entry. When you put all the pieces together, accounting is truly beautiful!

Conclusion

Today we figured out what general ledgers are and how to post to them. It was a fun day. Next time, we'll learn about posting the ending balance of these general ledgers to the trial balance.

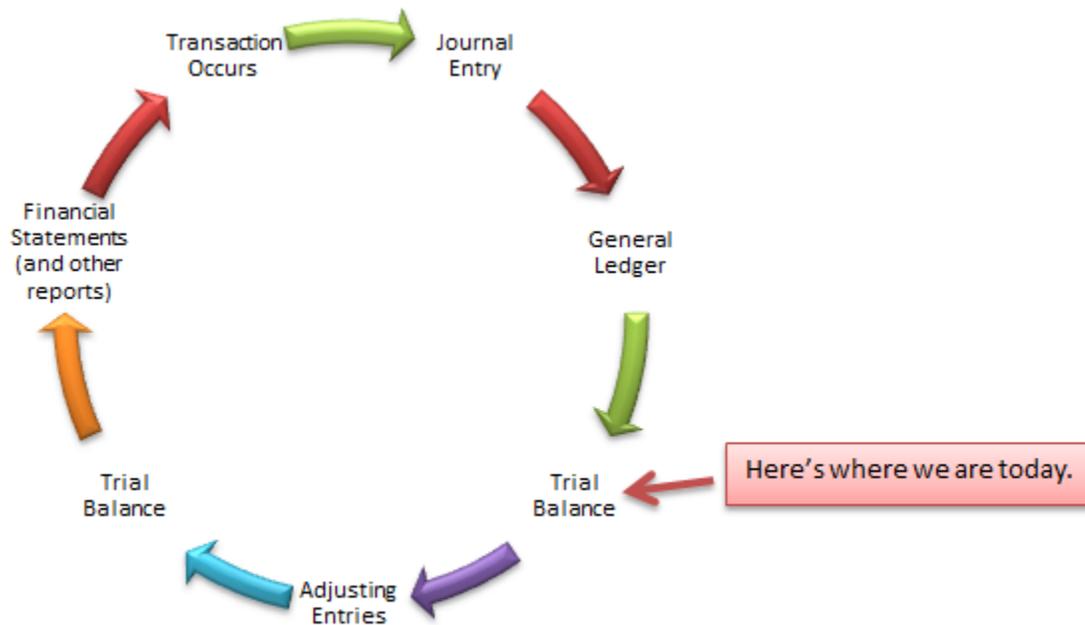
Side Note: Sub Ledgers

Some of the ledgers above are actually sub ledgers. Sub ledgers are smaller and more detailed than general ledgers. For example, above we have a ledger called 'Assets-Computers.' When you create your financial statements at the end of the year, your church probably won't show everyone how much money is wrapped up in computers. Instead it will combine computers, vehicles, and other equipment into one account called Property, Plant, and Equipment. Property, Plant, and Equipment would be the general ledger that is made up of the smaller, more detailed sub ledgers.

End of Lesson 10

Lesson 11: The Trial Balance

Today we'll learn about trial balances. In the last section we breezed through general ledgers. Ledgers are simply a tool to keep track of account balances. Let's see where we're at in the Church Accounting Cycle:



The Church Accounting Cycle of Doom

The trial balance is simply an aggregation of all the different ledgers or account balances. Accounting software will do this step for you automatically. You can also do this step manually in a jiff.

Below you can see an example trial balance. The first column on the left lists all of the account names for both the statement of activities and the statement of financial position. The next two columns list the debit or credit balance for the account.

1st Church Trial Balance		
Account Name	Debit	Credit
Cash	84,000	
Accounts Receivable	10,000	
Supplies	10,000	
Property Plant and Equipment	50,000	
Accounts Payable		10,000
Notes Payable		50,000
Contribution Revenue		50,000
Church Expenses		20,000
Net Assets		24,000
	154,000	154,000

Cash		
	Debits	Credits
Beg. Balance	100,000	
		20,000 #2
		5,000 #3
		1,000 #4
#5	10,000	
Current Balance	84,000	

To prepare the trial balance simply copy the general ledger account balances over to the trial balance.

The purpose of preparing the trial balance is to check for any errors that may have been made when entering journal entries. Notice at the bottom of the trial balance (pictured above) that the value of the debits equals the value of the credits. If debits don't equal credits on your church's trial balance, then you've made a mistake somewhere. Most often the mistake is simply a mistyped number.

Best Practices for an Unbalanced Trial Balance

If your trial balance doesn't balance, the first thing I'd check is to make sure you added up the columns in the trial balance correctly. Next I'd check to make sure you copied and pasted all of the ledger account totals over to the trial balance correctly.

After that, make sure you summed up the ledger totals correctly.

If you still haven't found the error at this point, you could be in for the long haul. You'll need to make sure all of your journal entries match the numbers you've put in the ledgers. If that's not the problem, then you'll simply need to look at each journal entry for errors.

To avoid this massive headache I recommend purchasing accounting software for your church. Accounting software will ensure that you avoid these mistakes. The software simply won't let you have an unbalanced trial balance. As you enter each transaction, the software will check to make sure everything is in order (if something is amiss it will notify you right away).

Creating a Trial Balance

To create your own trial balance, just take the current balance from all your ledgers, stick it on the appropriate side of the trial balance (debit or credit side), and total up the columns.

Discussion on the Usefulness of Trial Balances

If you are using church accounting software, then you probably won't be creating any trial balances. The trial balance is meant to catch journal entry errors. Accounting software simply won't allow you to make some of these errors. The software forces you on every entry to make debits equal credits. If you try to enter a journal entry where debits don't equal credits the software will give you a warning notice and it won't allow you to proceed until the value of the debits equals the value of the credits.

Even if you are using accounting software, it's good to know what a trial balance is because it helps you remember that debits must equal credits. It also helps you understand the accounting process.

Conclusion

Today we learned about the trial balance, now we're going to look at some adjusting entries that must be made before preparing the financial statements.

End of Lesson 11

Lesson 12: Adjusting Entries (Matching and Realization Principle)

Today, we'll take a look at some of the adjusting entries that are common in church accounting. Last time we talked about the trial balance.

After seeing that all your debits and credits balance in the trial balance, you're probably eager to take those numbers and create the financial reports. However, you still may need to make some adjustments to the numbers before posting.

How Do I Know if I Need to Make Adjusting Entries?

If you're going to be audited by a third party organization, then chances are you'll need to make a couple adjusting entries. There are two principles (rules) of accounting that make these adjusting entries necessary:

(1). The Realization Principle (for Revenue Recognition)

This principle states that all revenues should be recognized or recorded during the period that they are earned. For example, let's pretend that your church is holding a fundraising dinner on January 10th of the next year 20X2. The current date is December 30th 20X1. You've already sold 100 tickets at \$10 each and recorded \$1,000 worth of revenue for this year. Technically this revenue shouldn't be recorded until the next year when it is actually earned (to earn the revenue you must actually have the fundraiser dinner).

We'll pretend your bookkeeper accidentally made this journal entry in December. He debited cash for \$1,000 to show an increase in the cash asset. He also credited "Fundraiser Revenue" to show an increase in revenue.

Cash	\$1,000
Fundraiser Revenue	\$1,000
Cash Received for the January 1, 20X2 Fundraiser	

At the end of the year your accountant realizes that an adjustment needs to be made. Here's what the adjusting entry would look like:

Fundraiser Revenue	\$1,000
Unearned Revenue	\$1,000
Adjusting the fundraiser revenue account.	

You're getting rid of the fundraiser revenue (by debiting the account) and specifying that it's actually unearned revenue. Note that unearned revenue is a liability (you owe that fundraising dinner to the people). You increase a liability by crediting the account.

Next year after the fundraiser has been performed, you can recognize the revenue.

Unearned Revenue	\$1,000
Fundraiser Revenue	\$1,000
Fundraiser has been performed and revenue is earned.	

You'll debit the liability to get rid of it and credit the revenue to recognize it.

(2). The Matching Principle for Expenses

The matching principle matches all expenses with related revenues in the same period. The idea is to record all expenses in the proper time period. For example, let's pretend that your church pays its staff \$4,000 every two weeks. As of December 31, 20X1 your staff has worked one week of the two week work period. Usually you don't record the expense until the cash actually leaves your church. However, according to the matching principle you should record one week's worth of employee expenses during this period. Half of \$4,000 is \$2,000. Your church has accrued \$2,000 worth of expenses that should be reported.

Wage Expense	\$2,000
Wages Payable	\$2,000
Reporting the wage expenses for the last week of the year.	

You're recording wage expense during the time period that the expense occurred.

Common Adjusting Entries

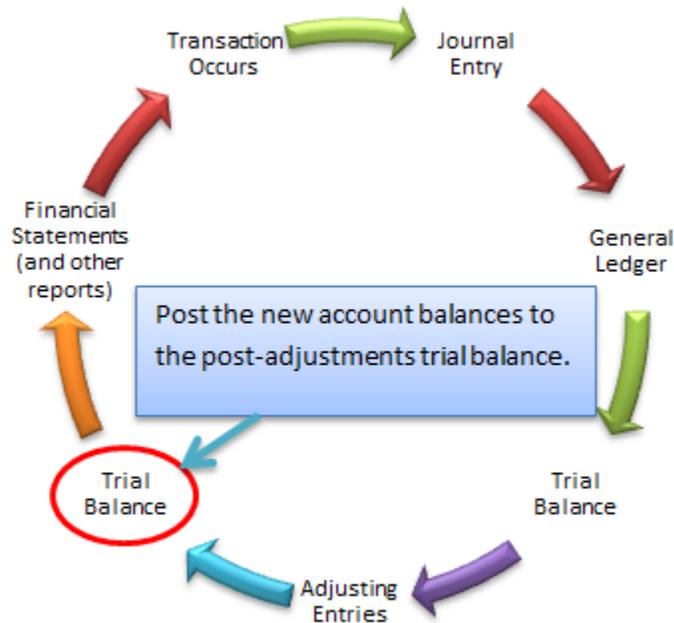
Below are the four common types of adjusting entries.

1. Accrued Expenses (ie. Expenses that have been incurred but haven't been recorded)
2. Unearned Revenues (ie. Revenues that haven't been earned but have been recorded)
3. Prepaid Expenses (ie. Expenses that will happen next year that you've already paid for)
4. Depreciation (ie. Physical assets that require a depreciation expense each year)

I don't want to get bogged down in adjusting entries in this introduction to church accounting. Most of the time these adjusting entries are done by a full-fledged accountant, but if you want to know more about them, let me know and I'd be happy to help.

Post Adjustment Trial Balance

You may have noticed that the Church Accounting Cycle of Doom has "Trial Balance" listed twice.



The Church Accounting Cycle of Doom

Making an adjusting entry will change your ledger accounts. This means you'll need to update your trial balance. If you're doing this manually then you'll need to take your new ledger balances and copy them over to the new trial balance. This updated trial balance is known as the post adjustment trial balance.

This is really a brief step, but it's worth mentioning so you can understand the process. Keep in mind that accounting software will automatically generate your post adjustment trial balance for you.

Conclusion

Today we learned a little about adjusting entries. Sometimes at the end of the year you have to make these entries to ensure that all revenues and expenses are recorded in the proper accounting year. After you make these entries, you post the new account balances to the post-adjustment trial balance. This trial balance is the one you will use to create your financial statements and reports (we'll discuss these reports in some detail in a few lessons).

Before we cover the financial statements and reports, we need to finally tackle the tough issue of fund accounting. We'll do that in the next lesson.

End of Lesson 12

Lesson 13: Two Types of Fund Accounting? The Tale of Two Accounting Systems

Special Note to the Reader: Before we begin talking about fund accounting I'd like to have a heart-to-heart talk from author to reader. I personally hope that the next two lessons don't leave a bad taste in your mouth for this book. Know that I've given a lot of thought about how to present this topic. I've read multiple books about nonprofit accounting and when they get to this topic, they all take the same approach: They give a brief head nod to the subject and then happily move on. In other words they quickly mention the topic, but don't cover it in enough depth to get you to the point where you'll actually be able to perform fund accounting.

I must admit that when I was writing this book I was sorely tempted to do the same. I mean, learning accounting is difficult enough. When you throw in the extra rules that come with fund accounting, then you're really in for a treat.

Hopefully you can see the tough decision I had to make. I could either present you with a book that was a dream to read but ultimately left you incapable of performing the task at hand or I could present you with a book that at times made you want to literally ring my neck and curse the inventors of accounting, but ultimately leaves you capable of performing the tasks you'll need to as an accountant.

After a long debate with my chief editor (bless her soul) I've decided to let you hate me for now in hopes that you will ultimately love me when you finish this book and you can actually perform the tasks that you'll need to.

With that in mind, I ask that you push through these next couple of lessons with patience for the author (me). The idea of fund accounting might still seem hazy by the time you finish Part 1 of this book. This time of haziness is (unfortunately) necessary.

In Part 2 of this book I will walk you through setting up a fund accounting system on QuickBooks (the most popular church accounting software in the world). I'll show you the journal entries and steps you'll need to take to perform fund accounting.

My hope is that once you're up and running you'll look back upon this time as necessary and productive.

A Tale of Two Accounting Systems

In the last lesson we talked about adjusting entries. Today we're going to talk about the rules of fund accounting, but first we're going to have a history lesson and learn some acronyms that will get you talking like a professional accountant (yes, your wildest dreams are about to come true).

Chances are you've heard something like, "Churches **must use fund accounting** or they will face the full wrath of the IRS, the United States Government, and all its allied nations." This is only partially true. Churches do need to categorize their net assets, but there's no requirement to account for every

program separately (this is the historical definition of fund accounting – more on this below). If you're a bit confused right now, then you need not feel worried. Many professional accountants and church accountants are confused as well. I'm hoping that sharing some history on the subject will clarify the matter for you.

Unrestricted, Temporarily Restricted, and Permanently Restricted Funds

Fund accounting is a very confused notion among those who have to deal with church accounting. Fund accounting has come to mean two different things and this has caused many people to wonder whether or not their church is required to use fund accounting. In this section we'll clearly explain the two types of fund accounting and then we'll talk about which method your church is required to use. For clarification purposes I have labeled these two types of fund accounting methods: (1) the traditional fund accounting method and (2) the FASB fund accounting method.

History Lesson

The Financial Accounting Standards Board (FASB – pronounced "Faz-Bee") is a group of accounting professionals who regulate how accounting reports should be presented. They issue statements called Statements of Financial Accounting Standards (SFAS – pronounced "Ess-Fass"). How's that for some jargon? Start talking to your friends about the Faz-Bee and Ess-Fass and you're sure to impress them.

Anyway, in June of 1993 the FASB issued two statements, or SFASs, for the nonprofit world (including churches). These statements are [SFAS 116 Accounting for Contributions Received and Contributions Made](#), and [SFAS 117 Financial Statements of Not-For-Profit Organizations](#). The rules in these statements make up the FASB fund accounting method (method 2).

Method 1: The Traditional Fund Accounting Method (Not Required)

Before we talk about the FASB fund accounting method in detail, we must discuss the traditional fund accounting method.

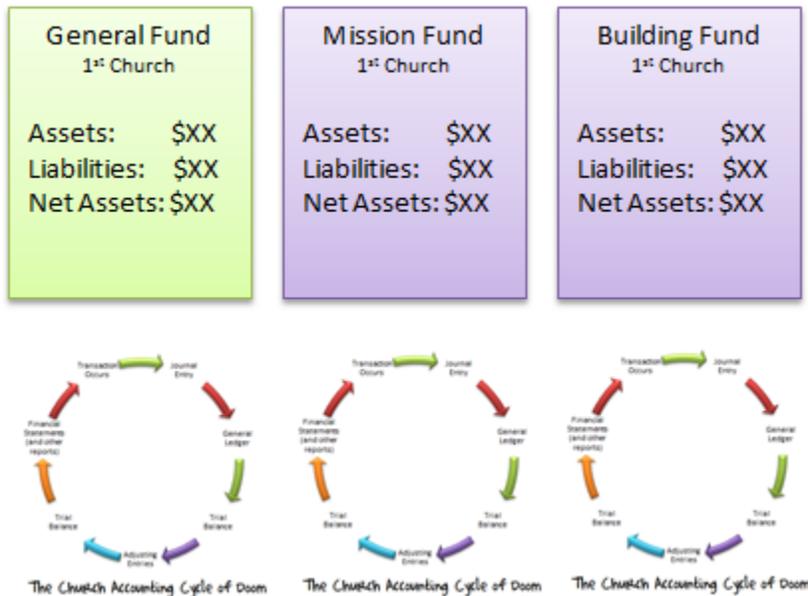
General Fund 1 st Church	Mission Fund 1 st Church	Building Fund 1 st Church
Assets: \$XX	Assets: \$XX	Assets: \$XX
Liabilities: \$XX	Liabilities: \$XX	Liabilities: \$XX
Net Assets: \$XX	Net Assets: \$XX	Net Assets: \$XX

Before SFAS 116 and 117, churches were required to use the traditional fund accounting method. This method entailed keeping separate asset and liability accounts for each fund or program within the church (see illustration above). Some examples of funds include the mission fund, the general fund, and

a fund set aside for buildings and land. The idea with this type of fund accounting is to track all of the incoming and outgoing resources for each program separately (“separately” being the key word there).

You can probably see how this would be useful for a church. At the end of the year, a church could print out the financial reports for each program and have a pretty detailed accounting of each program’s financial position. The church could see which programs were doing well and which programs needed some help. Again, I have classified this method of fund accounting as traditional fund accounting for learning purposes.

Huge Notice!!! Everything you’ve learned about accounting in the previous lessons is not rendered useless now that we’re learning about traditional fund accounting! Traditional fund accounting consists of transactions, journal entries, debits, credits, ledgers, assets, liabilities, trial balances, and financial statements. The only new thing here is that the traditional method of fund accounting separates this information into different programs. Perhaps the illustration below will help.



Instead of performing the Church Accounting Cycle of Doom for one general program like you would with a normal business, you perform the accounting cycle for several different programs. Note that this does not mean you have to do a lot more work! You simply have to set up your accounting software in the correct manner. The second half of this book covers how to do this on QuickBooks.

Method 2: The FASB Fund Accounting Method (The Required Method)

SFAS 116 and 117 introduced a different type of fund accounting. Basically, instead of accounting for each fund or program separately, the FASB made it so churches only have to report on three different funds: unrestricted funds, temporarily-restricted funds, and permanently-restricted funds. Instead of having different financial reports for each fund, the church simply has to list all of its unrestricted, temporarily-restricted, and permanently-restricted net assets on the statement of financial position (as

pictured below). This was an attempt to simplify nonprofit accounting (whether or not it accomplished this is a subject of some debate).

Note that we briefly mentioned the statement of financial position in lesson 2. We'll be covering it in more depth in lesson 15.

1st Church			
Statement of Financial Position			
As of December 31st, 20XX			
ASSETS:		LIABILITIES:	
Current Assets		Current Liabilities	
Cash	\$ 5,000	Accounts Payable	\$ 3,000
Receivables	5,000	Wages Payable	2,000
Supplies	5,000	Other Payables	1,000
Total Current Assets	15,000	Total Current Liabilities	6,000
Long Term Assets		Long Term Liabilities	
Land	50,000	Notes Payable	35,000
Building	75,000	Total Long Term Liabilities	35,000
Equipment	25,000	Total Liabilities	41,000
Less: Accum. Depreciation	(10,000)	NET ASSETS:	
Total Long Term Assets	140,000	Unrestricted	55,000
		Temporarily Restricted	10,000
		Permanently Restricted	49,000
Total Assets	155,000	Total Net Assets	114,000
		Total Liabilities and Net Assets	155,000

These FASB statements also affect the statement of activities (we briefly mentioned this report in lesson 2 and will cover it more in depth in lesson 16). For now, just know that the statement of activities tracks all the contributions and expenses of the church.

The image below shows how the statement of activities is different for churches than it is for normal businesses (you have SFAS 116 and 117 to thank for that).

Normal Business	
Revenues:	\$XXX
Expenses:	\$XXX
Net Income:	\$XXX

NonProfit or Church			
	Unrestricted	Temp. Restricted	Perm. Restricted
Revenues:	\$XXX	\$XXX	\$XXX
Expenses:	\$XXX	\$XXX	\$XXX
Net Income:	\$XXX	\$XXX	\$XXX

The FASB statements made it so contributions should be categorized into three different categories (unrestricted, temp. restricted, and perm. restricted).

Summary of Discussion to this Point

In summary, the traditional fund accounting method is where your church does the accounting for different programs separately. **The traditional fund accounting method is not required, though many churches find it useful. The newer FASB fund accounting method is required.**

Many churches continue to use the traditional fund accounting method for internal reports. It's very useful to have each fund tracked separately for church leaders and other decision makers. **If you're using the traditional fund accounting method you can still meet the requirements of the newer FASB fund accounting method.** In fact it's relatively easy to meet the FASB fund accounting requirements using the traditional approach. To understand why it's simple to meet the new fund accounting rules, let's take a look at what the rules actually are.

The New Rules

Rule: Churches must classify net assets and contributions into three different categories (listed below):

1. Unrestricted Funds – Unrestricted funds are simply monies and other assets that your church can use in any way it deems fit. This means that someone has contributed the money to your church and they haven't told you how they would like the money (or asset) used; there are no time or purpose restrictions on these funds. Most tithes and offering donations go into the unrestricted funds category.

2. Temporarily Restricted Funds – Temporarily restricted funds are temporarily restricted by time or purpose. Time restrictions aren't very common in my experience, but purpose-restricted donations are quite common. A time-restricted contribution means the donor has said your church can't use the money until a certain amount of time has passed. A purpose-restricted contribution is given by the donor for a specific purpose.

For example if a donor contributes \$5,000 for the mission fund, then that's a temporarily restricted fund because it is restricted to missionary use only. Your church has to keep track of and report on these temporarily restricted funds. Your church needs to make sure it uses these funds for their intended purpose.

3. Permanently Restricted Funds – As the name implies, permanently restricted funds represent those contributions that come with permanent restrictions. Students often laugh and wonder, “Why in the world would someone make a contribution with a permanent restriction on it?” These contributions have their purposes.

The best example is an endowment where the church is allowed to use all of the interest off of the donation, but none of the principal amount. Someone may give your church a million dollar permanently restricted donation. You can’t ever use the million dollars, but you can use all the interest from the million dollars.

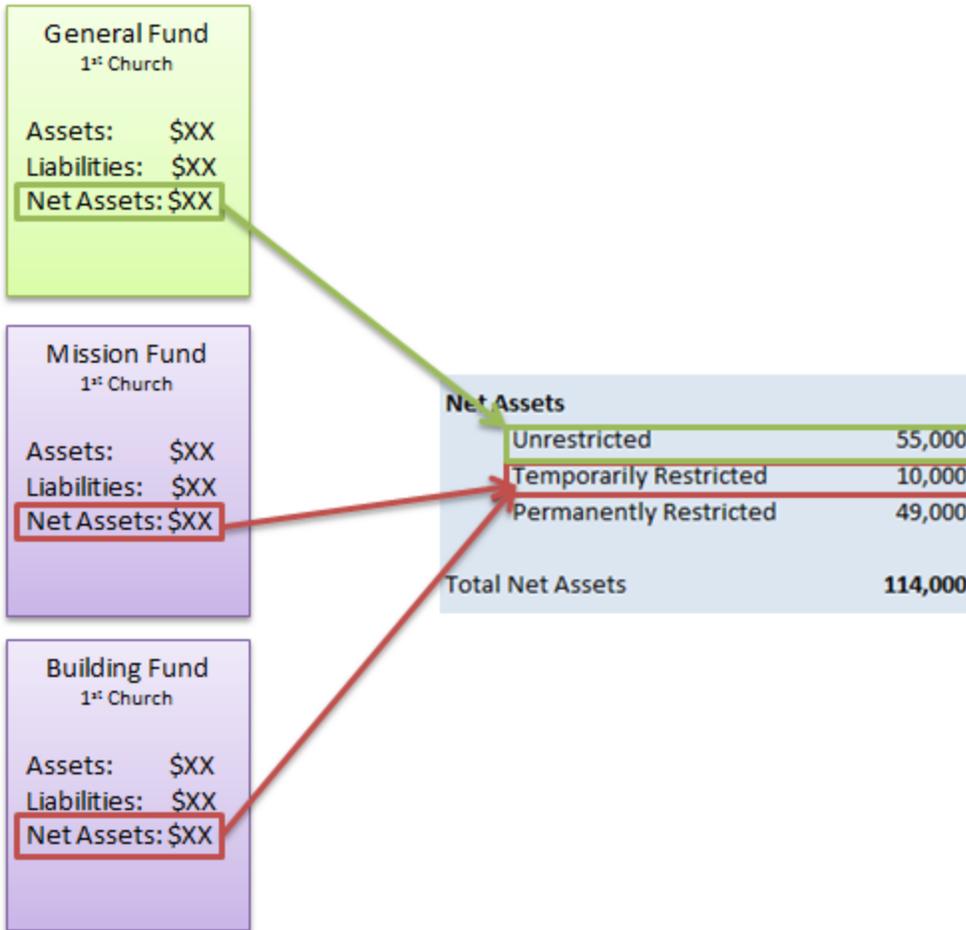
Which Method Should Your Church Use?

Your church **is not** required to keep track of each fund or program separately. Your church **is** required to keep track of unrestricted, temporarily restricted, and permanently restricted funds. So which method should you use? I think the best answer is both.

Your church should keep track of all the individual funds as separate entities. Tracking all the incoming and outgoing resources into these funds helps you see how your individual programs are doing. Although this method is not required, it’s very useful for your church leaders to be able to see how the building fund is doing or how the missionary fund is doing.

The great thing about using the traditional method is that it’s easy to come up with the required FASB fund accounting. When you’re creating your financial report simply add up all the separate programs’ net assets (the net assets for all the programs that have a specific purpose attached to them). That summed up amount is your **temporarily restricted** account balance.

For example, if my church only had two programs (a missionary program and a building program) I’d combine the net assets amount from the missionary program and the net assets amount from the building program to get my temporarily restricted net assets (see image below).



General Fund

There is always a general fund when you're using the traditional fund accounting method. This is the fund where you keep all the unrestricted net assets (see image above).

Temporary Funds

As discussed and illustrated above, you'll simply add up the individual temporarily restricted funds and place them in one category called "Temporarily Restricted Net Assets."

Quick Note on Permanent Restrictions

The nature of permanent restrictions makes them easy to keep track of (they are usually large donations and don't happen very often). You can create an endowment fund (or multiple endowment funds, if you want to track them separately) for permanent restrictions and you're set.

In part 2 of this book about QuickBooks, I'll show you how to set up a system that tracks each program individually. You'll then be able to combine the programs at the end of the year to create FASB compliant reports.

Summing it All Up

There are two different meanings for fund accounting: (the traditional fund accounting method and the FASB fund accounting method). The traditional method performs accounting separately for each program or fund within the church. This method is not required, but it is useful. The FASB fund accounting method makes sure churches keep track of unrestricted, temporarily-restricted, and permanently-restricted net assets on their statement of financial position. The FASB fund accounting method is required. Most churches find it useful to do both.

In the next section I'll show you some adjusting entries that need to be made in order to stay in compliance with SFAS 116 and 117.

End of Lesson 13.

Lesson 14: How to Account for Temporarily Restricted Contributions

According to the Financial Accounting Standards Board (FASB), churches should categorize their contributions into three different categories: unrestricted, temporarily restricted, and permanently restricted contributions. We talked about the definition of these categories in the previous lesson. Today, we'll briefly review these definitions, look at an example transaction, and look at how this transaction affects the statement of activities for your church.

Review

Unrestricted contributions are any contributions your church receives that don't have any strings attached. The member simply gives your church the donation allowing you to spend it any way you see fit.

Temporarily restricted contributions are given with a temporary restriction. In essence, the member gives the donation to your church and says that the money should be spent for a specific purpose.

Permanently restricted contributions are donations that have a permanent restriction on them. An example is an endowment where your church is free to use the interest gained from the endowment. The interest of the endowment is considered unrestricted.

Example: Donation Intended for Missionaries

Let's say that a man named Bill Gates attends your church. He leaves a \$5,000 contribution with a slip in the envelope that says, "Use to purchase new computers for missionaries." This is an example of a temporarily restricted contribution. The money is restricted until you decide to buy new computers for the missionaries at which point it becomes unrestricted. Let's look at the journal entry that should be made on the date of the contribution.

You're increasing cash which is an asset so you'll debit that account (remember the rules from previous lessons). You're increasing revenue so you'll credit that account.

The difference this time is that you're marking the cash and revenue as temporarily restricted. This fulfills the FASB requirements we talked about in the previous lesson.

Cash-Temp. Restricted	\$5,000
Contribution Revenue-Temp. Restricted	\$5,000
Received \$5,000 from a member for new computers.	

Alternatively if you were accounting for each program fund separately (using the traditional accounting method we talked about in the last lesson) your journal would look like this:

Cash-Missionary Fund	\$5,000
Contribution Revenue-Missionary Fund	\$5,000
Received \$5,000 from a member for new computers.	

In the above journal entry you're still debiting cash and crediting contribution revenue. The main difference is that you are marking each account as "Missionary Fund" instead of "Temporarily Restricted."

Here's what your statement of activities would look like at this point (assuming you also received \$50,000 in unrestricted contributions):

1st Church Statement of Activities For the Year Ended December 31st, 20XX				
	Unrestricted	Temp. Restricted	Perm. Restricted	Total
REVENUE:				
Contributions	50,000	5,000		55,000

The \$5,000 set apart for the missionary program is temporarily restricted.

Continuing the Example

At this point in time your church has \$5,000 in temporarily restricted contribution revenues. Now, let's say that your church goes out and buys a new Apple MAC Pro computer (ironic, I know, considering the donor). Your church also buys an iPad. All these computers are for the missionary program. The total cost is \$3,000. Let's look at the journal transaction at this point.

Net Assets Released from Restriction – restricted fund	\$3,000
Net Assets Released from Restriction – unrestricted fund	\$3,000
Purchased \$3,000 worth of computers using designated funds.	

The 'Net Assets Released from Restriction' account is simply an account used to transfer temporarily restricted funds to unrestricted funds.

Remembering back to our journal entry rules, net assets are increased with a credit and decreased with a debit. So in the above journal entry you are increasing the unrestricted funds and decreasing the restricted funds.

Here’s what your statement of activities will look like at this point:

1st Church				
Statement of Activities				
For the Year Ended December 31st, 20XX				
	Unrestricted	Temp. Restricted	Perm. Restricted	Total
REVENUE:				
Contributions	50,000	5,000		55,000
Net Assets released from restrictions	3,000	(3,000)		0
Total Revenue	53,000	2,000	0	55,000

Notice that your total revenues haven’t changed (they are still \$55,000). The amount of temporarily restricted revenues has changed from \$5,000 to \$2,000.

Wrapping Up

Today we reviewed the different fund categories required by the FASB. We looked at the example journal entries necessary and at how the statement of activities is affected by this type of transaction.

This ends our brief detour of talking about fund accounting. We’ll still see it rear its ugly head from time to time and we’ll cover it in depth some more when we’re setting up an accounting system in part 2 of this book.

Transitioning

Now, we’ll be transitioning to the financial statements. We’ve already had a preview of these statements in Lesson 2. In the next few lessons we’ll cover in-depth the four most important reports your church will create: the statement of financial position, the statement of activities, the cash flow statement, and the year-end donor summary report.

End of Lesson 14

Lesson 15: The Statement of Financial Position

Phew! We finally made it to the financial reports (the main reason we're doing all this accounting in the first place). Today we'll learn about the statement of financial position (one of the most important financial statements a church can create). At the beginning of these lessons we talked about keeping the end goal in mind as you studied the Church Accounting Cycle. Well, I'm happy to report that we've arrived (the goal being to create reports for the church board of trustees and any independent third parties who want to see your church's financial statements).



Why Are Financial Reports Important?

You can go here for a great, in-depth read on [why financial statements are important for churches](#).

Basically, the church board of trustees (especially the finance committee) can use these reports to look at how the church is doing financially. They can then use these reports to make important decisions about the future of your church. These decisions can be critical to the overall health of your church! Churches need wise financial managers in order to survive.

Your church may need these reports in order to get a grant or a loan. Banks will require these financial statements if your church is trying to get a loan. If the statements are audited by a CPA, then your statements look even better to the bank.

Now that we know why these statements are important, let's get back to talking about the statement of financial position.

The Statement of Financial Position

For-profit companies call this statement the balance sheet, but I personally believe the statement of financial position is a more descriptive name (and it just happens to be the name used by churches and other nonprofits). This report is designed to show the overall financial position of your church. It does this by listing out all of your church’s assets, all of your liabilities, and then it subtracts liabilities from assets to clearly show the reader whether your church has more assets or more liabilities. Can you see how this information would be useful to a bank? I sure hope so. I mean, if you’re going to lend someone money you want to make sure they’re going to be able to pay it back at some time in the future. If they already have more debt than they have assets, then it’s more risky to lend to them, and many banks won’t do it.

1st Church			
Statement of Financial Position			
As of December 31st, 20XX			
ASSETS:		LIABILITIES:	
Current Assets		Current Liabilities	
Cash	\$ 5,000	Accounts Payable	\$ 3,000
Receivables	5,000	Wages Payable	2,000
Supplies	5,000	Other Payables	1,000
Total Current Assets	15,000	Total Current Liabilities	6,000
Long Term Assets		Long Term Liabilities	
Land	50,000	Notes Payable	35,000
Building	75,000	Total Long Term Liabilities	35,000
Equipment	25,000	Total Liabilities	41,000
Less: Accum. Depreciation	(10,000)	NET ASSETS:	
Total Long Term Assets	140,000	Unrestricted	55,000
		Temporarily Restricted	10,000
		Permanently Restricted	49,000
		Total Net Assets	114,000
Total Assets	155,000	Total Liabilities and Net Assets	155,000

Take some time to look over the statement of financial position example pictured above. We’ll talk about its features below.

Current Assets – Starting in the top left of the statement we see current assets listed. Current assets are all the assets or resources your church owns that will likely be converted into cash or used up within the next year. Common examples of this type of asset include cash, any receivables your church might have, and supplies that will be used within the next year.

Long Term Assets – Long term assets are all those assets that won't be used up or converted to cash within the next year. Common examples include your church's land, building(s), and equipment.

At the end of the first column, you sum up all of the assets into a category called total assets.

Where do the Numbers Come From?

You probably notice in the above example that cash has a balance of \$5,000. Where did the accountant get that number? Did he simply count up cash at the end of the year and then write it in? Unfortunately, accounting is not that simple. While this 'counting up' method might work for cash, it won't work for supplies and other assets. Can you imagine counting all your supplies, buildings, cash, and other assets each time you needed a report?

The good news is that these numbers come from the Church Accounting Cycle or system we've been talking about. The numbers are simply taken from the post-adjustment trial balance (that we talked about in lesson 12) and posted to the appropriate account name (known as a line-item) on the statement of financial position. This means that if you've been doing all your accounting during the year, then the end of the year can be relatively painless and inexpensive; just copy and paste the information over to your reports!

Of course, church accounting software will do this all for you, if you've entered the transactions correctly. Look at the trial balance pictured below and then look at the statement of financial position above. Can you see where the numbers have simply been copied and pasted to the statement of financial position?

1st Church Trial Balance		
Account Name	Debit	Credit
Cash	5,000	
Accounts Receivable	5,000	
Supplies	5,000	
Property Plant and Equipment	140,000	
Accounts Payable		3,000
Wages Payable		2,000
Other Payables		1,000
Notes Payable		35,000
Net Assets		114,000
	155,000	155,000

Remember that these numbers on the trial balance come from the balances on the individual general ledgers or T-Accounts discussed earlier. Hopefully you're starting to see how this cycle works! It's pretty neat, actually.

Below is a massive sentence (probably with a few grammatical issues) that sums up nicely everything we've learned to this point.

A transaction occurs, a journal entry is recorded, the numbers from the journal entry are posted to the ledgers, the numbers from the ledgers are posted to the trial balance, adjusting entries are made, the trial balance is updated, and the numbers from the updated trial balance are copied and pasted over to the financial reports.

Read that sentence over a few times and make sure you understand it. If you understand that sentence, then you understand the accounting process and you're officially an accounting genius.

Now that you know where these numbers are coming from, let's get back to understanding everything on the statement of financial position.

Liabilities

In the right column of the statement above, you have all your church's short-term and long-term liabilities.

Current Liabilities are all the liabilities that your church expects to pay off in the next year. Common examples include accounts payable to suppliers and wages payable.

Long-Term Liabilities are all the remaining liabilities that your church doesn't expect to pay off in the next year. A common example is a mortgage payable, often called a note payable.

Why the Separation Between Current and Long-Term?

One common question among those learning church accounting for the first time is, "Why do we have to separate current and long-term assets and liabilities?" Separating these items helps the user of the report see how capable your church is of meeting its current debts. If your church has more current liabilities than current assets, this is generally considered a bad sign because it means your church will have a hard time paying off its debts that come due during the next year.

Net Assets

Net Assets	
Unrestricted	55,000
Temporarily Restricted	10,000
Permanently Restricted	49,000
Total Net Assets	114,000

If you'll remember back to the famous accounting equation (assets = liabilities + net assets) you'll see that the statement of financial position is based off of this equation. After all the assets and liabilities are

listed, the net assets are listed. The net assets are simply the surplus of assets your church has over liabilities. $Assets - Liabilities = Net Assets$.

If your total liabilities are greater than your total assets, then you have negative net assets... and that's a bad thing. Best to avoid that if possible. 😊

Note that your church should list net assets in three different categories or funds: unrestricted, temporarily restricted, and permanently restricted.

Final Words on this Statement

Hopefully you notice the perfect balance that takes place in accounting. At the end of the statement of financial position, you should note that the value of total assets is equal to the value of total liabilities + net assets. This balanced world has caused many people to become accountants.

Total Assets	155,000	Total Liabilities and Net Assets	155,000
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Balance in both life and in accounting is good.

Summary

The statement of financial position shows the financial position of your church. It's divided up into three main categories (assets, liabilities, and net assets). Assets and liabilities are classified as either current or long-term. This helps readers of the report understand whether the church will be able to pay off its debts in the next year. Net assets are categorized as unrestricted, temporarily restricted, or permanently restricted. In the next lesson we'll be discussing the statement of activities in detail.

End of Lesson 15

Lesson 16: The Statement of Activities

In the last lesson we talked about the statement of financial position. Now we're going to move on to a different financial statement: the statement of activities (also known as the income statement). In this lesson, I'll discuss the main items on this statement.

Take a good look at the example statement of activities below.

1st Church				
Statement of Activities				
For the Year Ended December 31st, 20XX				
	Unrestricted	Temp. Restricted	Perm. Restricted	Total
REVENUE:				
Contributions	50,000	5,000		55,000
Net Assets released from restrictions	3,000	(3,000)		0
Interest Income	1,000			1,000
Event Income	10,000			10,000
Endowments			10,000	10,000
Total Revenue	64,000	2,000	10,000	76,000
EXPENSES:				
Wage Expense	30,000			
Utilities	3,000			
Missionary Program	2,000			
Youth Program	3,000			
Other Program	5,000			
Admin. Expense	10,000			
Fundraising Expense	5,000			
Depreciation Expense	5,000			
Total Expenses	63,000	0	0	63,000
Change in Net Assets	1,000	2,000	10,000	13,000
Net Assets, Beginning	54,000	8,000	39,000	101,000
Net Assets, End	55,000	10,000	49,000	114,000

Notice that all of the revenues are listed first, followed by all the expenses. These are only the revenues and expenses for this year (or for this reporting period, if you use something other than the calendar year). Revenues and expenses from last year aren't included on this statement.

Net Income and Net Assets

Revenues minus expenses equals net income right? Well it does for a normal business, but church's don't have net income (because they aren't out to make a profit). Instead, churches have net assets.

Business Equation: (Total Revenues) – (Total Expenses) = (Net Income for the Year)

Church Equation: (Total Revenues) – (Total Expenses) = (Change in Net Assets for the Year)

Now that we've talked about revenues, expenses, and net income let's take a look at the net assets section of the statement of activities (found at the bottom of the statement):

Change in Net Assets	1,000	2,000	10,000	13,000
Net Assets, Beginning	54,000	8,000	39,000	101,000
Net Assets, End	<u>55,000</u>	<u>10,000</u>	<u>49,000</u>	<u>114,000</u>

The equation here is that you take the beginning net assets, you add the change in net assets for the year (the net income for a normal business), and you come up with your ending net assets.

The total ending net assets of the church are actually all the net income or net profits saved up by your church over the years.

Note that this is the same net asset information that shows up on the statement of financial position. We'll talk more about this relationship next (I'm sure you'll find it as fascinating as I do).

Special Relationship between Statement of Activities and Statement of Financial Position

The statement of activities only contains accounting information for a one year period. After that, the accounts are all zeroed out (see our discussion here on [temporary accounts and closing out](#)). The statement of financial position on the other hand contains running balances. The accounts are never zeroed out. So what happens to the numbers that are zeroed out on the statement of activities? They are sent to the statement of financial position in the form of net assets.

Take a look at the picture below:

	Unrestricted	Temp. Restricted	Perm. Restricted	Total
Total Revenue	64,000	2,000	10,000	76,000
Total Expenses	63,000	0	0	63,000
Change in Net Assets	1,000	2,000	10,000	13,000
Net Assets, Beginning	54,000	8,000	39,000	101,000
Net Assets, End	55,000	10,000	49,000	114,000

This is a summarized version of the same statement of activities we talked about earlier in this lesson. I've simply hidden all the individual expenses and revenues to illustrate the point I'm about to make.

Total expenses subtracted from total revenues equal the change in net assets for the year ($76,000 - 63,000 = 13,000$). Add that amount to the beginning net assets amount which has been accumulated from all the previous years and you have your new ending net asset amount ($13,000 + 101,000 = 114,000$).

All the revenue and expense accounts are zeroed out at the end of the year, but the net asset information finds a home on the statement of financial position. Let's look at the statement of financial position that we talked about a couple lessons back (you're in for a big treat here).

1st Church
Statement of Financial Position
As of December 31st, 20XX

ASSETS:		LIABILITIES:	
Current Assets		Current Liabilities	
Cash	\$ 5,000	Accounts Payable	\$ 3,000
Receivables	5,000	Wages Payable	2,000
Supplies	5,000	Other Payables	1,000
Total Current Assets	15,000	Total Current Liabilities	6,000
Long Term Assets		Long Term Liabilities	
Land	50,000	Notes Payable	35,000
Building	75,000	Total Long Term Liabilities	35,000
Equipment	25,000	Total Liabilities	41,000
Less: Accum. Depreciation	(10,000)	NET ASSETS:	
Total Long Term Assets	140,000	Unrestricted	55,000
Total Assets	155,000	Temporarily Restricted	10,000
		Permanently Restricted	49,000
		Total Net Assets	114,000
		Total Liabilities and Net Assets	155,000

	Unrestricted	Temp. Restricted	Perm. Restricted	Total
Total Revenue	64,000	2,000	10,000	76,000
Total Expenses	63,000	0	0	63,000
Change in Net Assets	1,000	2,000	10,000	13,000
Net Assets, Beginning	54,000	8,000	39,000	101,000
Net Assets, End	55,000	10,000	49,000	114,000

The information from the statement of activities goes to the statement of financial position.

It turns out that all the revenues and expenses from the beginning of your church's existence are reflected on the statement of financial position! The statement of activities is wrapped up into the statement of financial position. The statement of activities gives you more detail about this year's revenues and expenses. The statement of financial position gives you summarized financial information about your church from the beginning of its existence. Pretty cool, right? Accountants (sadly, myself included) get very excited about this. We feel rather clever that we've created a way for the statement of activities to live on even after it dies. This information 'lives on' in the form of net assets on the statement of financial position. Take some time to study the pictures above. This is accounting at its absolute best. If this excites you, then you should consider becoming a full-fledged accountant!

Fund Categorization

Okay so we've covered most of the statement of activities, but we still need to mention fund categorization (unrestricted, temporarily restricted, and permanently restricted funds). We talked about this categorization in some depth in lessons 13 and 14. This categorization also impacts the statement of activities. Take a look at the following image which illustrates the difference between a normal business and a church statement of activities.

Normal Business		NonProfit or Church		
		Unrestricted	Temp. Restricted	Perm. Restricted
Revenues:	\$XXX	\$XXX	\$XXX	\$XXX
Expenses:	\$XXX	\$XXX	\$XXX	\$XXX
Net Income:	\$XXX	\$XXX	\$XXX	\$XXX

A normal business doesn't have to categorize its expenses like your church does. In lessons 13 and 14 I showed you how to make the journal entries that will lead to the correct categorization. In part 2 of this book I'll show you how to set up QuickBooks to accomplish this same categorization goal.

Wrapping Up

Today we learned that the statement of activities lists all the revenues and expenses for the church for a given period of time (usually a year). We learned that Total Revenues – Total Expenses = Change in net assets for the year. We also learned that the information from the statement of activities ends up on the statement of financial position in the form of net assets (an accounting miracle if I've ever seen one). Finally, we learned that revenues and expenses are broken up into three categories on the statement of activities (unrestricted, temporarily restricted, and permanently restricted).

Tough day right? Tomorrow, things get better as we discuss the third major financial statement (the statement of cash flows).

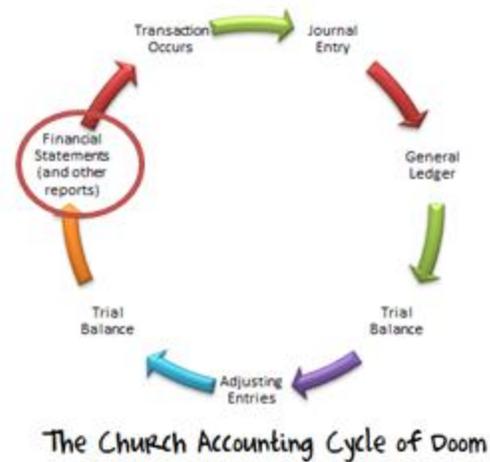
End of Lesson 16

Lesson 17: Cash Flow Statement

In this lesson, we'll talk about your church's statement of cash flows. The phrase "Cash is King" is very common in the for-profit world, but the statement definitely applies to churches as well. It's impossible to keep your church running if the church doesn't have the cash necessary to pay the bills. Keeping track of your church's cash flows is very important and the statement of cash flows can help your church leaders understand the cash flow situation.

The statement of cash flows shows the all the inflows of cash to your church and all the outflows of cash from your church. Common cash inflows include money received from contributions, tithes, fundraisers, or grants. Common cash outflows include money used for utilities, rent, upkeep, wages, and taxes. Basically this statement shows where your church gets its cash and how it uses its cash.

An Example Statement of Cash Flows



The Church Accounting Cycle of Doom

1st Church
Statement of Cash Flows
For the Year Ended December 31st, 20XX

Cash Flow From Operating Activities

Receipts:

Contributions/Offerings 55,000

Event Receipts 21,000

Total Receipts: **76,000**

Cash Disbursements: (25,000)

Net Cash from Operating Activities: **51,000**

Cash Flow from Investing Activities

Purchase of Property, Land, and Equipment (50,000)

Net Cash from investing Activities: **(50,000)**

Cash Flow from Financing Activities

Bank Loans 50,000

Repayment of Loans (10,000)

Net Cash Provided from Financing Activities **40,000**

Net Increase in Cash 41,000

Cash at Beginning of Year 10,000

Cash at End of Year **51,000**

As you study the above statement of cash flows, notice that it's broken into three different sections: Cash Flow from Operating Activities, Cash Flow from Investing Activities, and Cash Flow from Financing Activities. The statement is broken into three different categories to make it easier to see where your cash is coming from and where it's going.

Accounting Note: Any time you see numbers in parenthesis on an accounting report this means that the number is negative and should be subtracted. In the above example total receipts equaled \$76,000. Total disbursements (\$25,000) in parenthesis means that you subtract \$25,000 from \$76,000 to get your net cash received.

Cash Flow from Operating Activities

This section represents all the cash received and used for the normal day-to-day operations of the church. Weekly contributions and tithes will be recorded as inflows in this section and the day-to-day

expenses will be recorded as outflows in this section. In the example above, the total inflow from operating activities is \$76,000. The total outflow is \$25,000. The net or surplus cash from operating activities is \$51,000 for 1st church (the church used in the example above).

Here's one good rule of thumb for knowing which cash flows to put under the operating activities section: If it doesn't fall under investing activities or financial activities (defined below), then it's an operating activity.

Cash Flow from Investing Activities

The term 'Investing Activities' is referring to cash inflows and outflows from purchases or sales of long-term assets (or investments) like land, buildings, and equipment. Long-term assets are assets that will have a useful life of more than one year. If your church purchased \$50,000 worth of land this year, then this would be recorded in the investing activities section as an outflow (as in the example above).

Any investments you make in stocks, bonds, t-bills, etc. are also recorded in this section. If your church invests in the stock market, this would be a cash outflow. If your church sold these investments it would be a cash inflow. Oddly enough, the interest or dividends received from these investing activities are reported in the operating activities section (one of the quirks of accounting).

Cash Flow from Financing Activities

For churches, financing activities include taking out a note from the bank (borrowing money from the bank), repaying the note or debt, and receiving permanently restricted contributions (long-term endowments). In the cash flow statement above, the church borrowed \$50,000 from the bank (an inflow) and it paid back \$10,000 worth of its debts (an outflow).

Preparing the Cash Flow Statement

In general there are two methods for preparing the cash flow statement: the direct method and the indirect method. We won't go into detail about these two methods here. I may show you how to do this in a future lesson for those interested, but most church accounting software can do this for you automatically.

Conclusion

Today we learned that keeping track of cash is a very important part of keeping the church finances going. The cash flow statement summarizes all the inflows and outflows of cash into three sections: operating activities, investing activities, and financing activities. Operating activities represent the day-to-day transactions and everything not included in the investing and financing sections. Investing activities include the purchase and sale of marketable securities (bonds, stocks, etc.) and long-term assets (buildings, land, and equipment). Financing activities include loans, debt repayment, and permanently restricted contributions.

We've just about done all the reporting necessary for a church! We've covered the major financial statements, in the next lesson we'll talk about the year-end contribution statement.

End of Lesson 17

Lesson 18: Year End Church Contribution Statement and Donation Receipts

So far we've talked about general accounting reports in these lessons, but what about the year-end donation statements for the members of your church? Unfortunately a traditional accounting system won't put you in a situation to easily produce these reports.

Why Are Contribution Receipts Important?

Members of your church may take a tax deduction on their cash contributions to your church (The word cash is used broadly in accounting. It also includes credit cards, debit cards, and checks). In this lesson we won't be talking about non-cash contributions such as physical gifts. If you scroll down to the very bottom of this article, I have links to detailed articles explaining all types of contributions.

These tax deductions are a big deal to many church members. In order to claim these tax deductions your members need a, "record of the contribution in the form of either a bank record or a written communication from the charity – the charity being your church ([taken from IRS Pub. 1771](#))."

In short, your members need some sort of contribution receipt or statement from your church if they want to deduct their charitable contributions on their individual tax returns (and trust me, they do).

Easy Way and Hard Way

Now, there's an easy way to do this and a hard way to do this. The easy way is to simply keep track of all the member's donations throughout the year. At the end of the year, you issue the member a statement that shows all his/her contributions throughout the year. The member then has one piece of paper for tax purposes.

The hard way to do this is to issue a separate contribution receipt each time the member donates. This method means more work for you as the church accountant and more work for the member trying to keep track of all the different receipts until tax time. Tax time is hard enough as it is – do yourself and your members a favor and just print out one year-end giving statement for each member.

Requirements for Church Contribution Statements

The IRS doesn't have a special form for these statements (thank heaven for that, because we all know how unsightly and confusing most IRS forms are). However, the contribution statement does have a few requirements (listed below):

- Name of your church
- Name of member donating
- Amount of each cash contribution and the date it was given (see example below)

- A statement that no goods or services were provided by the organization in return for the contribution (if that's the case).
- A statement that any goods or services provided in return for the contribution consisted entirely of intangible religious benefits (if that's the case).

Example of Year End Church Contribution Statement

1st Church	
755 North Street Way Church City, State, Zip Code	
Annual Charitable Cash Contributions	
Donor: John Doe	
Date: Jan 31 st , 20X2	
This statement contains a record of voluntary contributions to 1 st Church made by John Doe during the 201X year. No goods or services were provided by 1 st church in return for these contributions other than intangible religious benefits.	
Date	Total
22 Jan 201X	\$705.05
31 Mar 201X	\$400.03
19 May 201X	\$1,015.00
1 Dec 201X	\$290.77
Total:	\$2,410.85

That's it. That's all your church needs. Pretty simple, right?

Creating this form in QuickBooks

Here's a lesson that shows you [how to create the year end donor summary in QuickBooks](#).

Other Examples

If you have Microsoft Word, then you can actually find quite a few free non-profit templates here: <http://office.microsoft.com/en-us/templates/CT010256691.aspx#>. Microsoft has contribution receipts, fundraiser templates, and more.

Conclusion

Don't make these contribution statements more difficult than they need to be. It's really quite a simple statement. If you have some church accounting software, you can really speed the process up because you've already entered the information, so these year-end statements can be created automatically.

Other Resources

[More Detailed Rules for General Contributions](#)

[How to Deal with Non-Cash Contributions in Your Church](#)

[Managing Stock and IRA Contributions](#)

[Contributions of Cars, Boats, and Airplanes](#) (Hey, you just never know when your church might receive an airplane)

End of Lesson 18 and Course 1

This is the end of the first course. It was meant to be an introduction to church accounting. After reading it you should understand the accounting principles you'll need as a church treasurer or leader.

The next course is called the Start to Finish Guide to Using QuickBooks for Your Church. It is a lot more hands on than this first course. In Course 2 you'll start using all the principles you just learned in Course 1.