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Church Accounting: Is There Only One Way?

By Daryl V. Burckel and Bruce Swindle

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A prescribed method of accounting and financial reporting for churches in the U.S. is not mandatory even though the AICPA has issued Statements of Position regarding accounting principles and reporting practices for certain nonprofit organizations.

Nevertheless, the business transactions of the church take place in a dynamic economy and require a proper accounting process for stewardship and ministry reporting.

The diversity in church accounting may be due to denominational independence. Many churches are autonomous units and reporting practices are not prescribed by their denominations. However, the question must be asked, "What method of accounting is best for churches?" Some have advocated an accrual basis concept, some a strict cash basis, while others have advocated a modified accrual basis.

The Church Accounting System

Many alternative ways exist to organize a church's accounting

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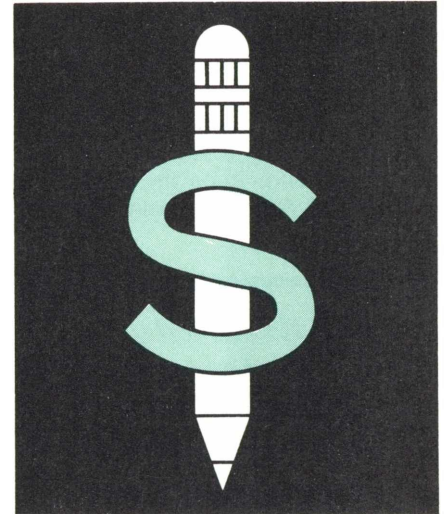
system. The degree of simplicity or sophistication of the system depends upon the individual church. Many churches fill administrative positions with volunteers while others hire personnel for the tasks.

The majority of this nation's 350,000 churches have under 200 active members [Boyce, 1984]. The pastor is frequently the only full-time worker in small churches. Therefore, the accounting work of small churches is done by volunteers who rely mostly on direct contact with people and events rather than reports.

Churches with large memberships employ multiple staff members. These churches may have a senior pastor, associate pastor, youth minister, and a music minister. They also frequently employ a full-time administrator to direct the accounting and financing activities of the church organization.

Regardless of membership size, churches provide a wide variety of ministries to church members. Therefore, churches should strive to make the most efficient use of monies, while avoiding waste and mismanagement. Church accounting systems help achieve this goal. The objectives of church accounting systems have been defined as follows [Woodward, 1976]:

1. To produce complete and accurate information as the basis for the handling of the



financial affairs of the church in a business-like manner,

2. To secure a sound financial foundation,
3. To keep members accurately informed on current financial matters and encourage their more active support.

Accounting Methods

Three methods of accounting most commonly recommended for church use are the cash, accrual, and modified accrual bases. A modified accrual basis is basically the same as the cash basis except for the recording of certain accruals. The modified basis of accounting recognizes:

1. Revenues in the accounting period in which they are both measurable and available to finance expenditures; and
2. Expenditures in the accounting period in which the liabilities are both measurable and incurred [Henke, 1983].

For instance, a church using the modified accrual basis of accounting would accrue revenue from the leasing of church-owned

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properties but would defer the recognition of revenues from money collections, even though supported by pledges until actually received.

The method of accounting to be implemented for a particular church depends upon the reports that will be generated and whether

The diversity in church accounting may be due to denominational independence.

they will be understood by the members. It is unreasonable to think that one basis of accounting would best serve all church memberships. Churches vary in size, finances, organization, charter, and many other aspects which necessitate different accounting practices to convey relevant financial information.

The Appropriate Accounting Method

Since there are no hard and fast rules for selecting a basis of accounting for a church, the following general guidelines are proposed for implementing the three methods of accounting listed above.

Cash Basis

The cash basis of accounting is appropriate for most small churches and churches whose only income source is collections or donations. Certainly, no accruing of revenues would be appropriate and a well-organized cash disbursement schedule would likely be a fair report of the church's financial

activities. Most, if not all, expenses would be paid monthly. Possible exceptions could include supplies and insurance. However, in churches with small memberships, neither of these costs are likely prepaid far in advance.

The Modified Accrual Basis

The modified accrual basis, similar to the system used by state and local governments, may be adaptable to many churches' needs. As churches grow in membership size, wealth, and age, it is not unusual for them to inherit property, receive large financial and other property gifts, and even purchase revenue-generating investments. These churches may be earning income on investments and leases that appropriately would be reported on the accrual basis. Nevertheless, the largest single source of income remains money collections. These collections, even though frequently supported by pledges, still would be reported on the cash basis.

Also, larger churches may benefit from a well-organized fund accounting system. Today, many churches provide diverse ministries such as schools (preschool through university), recreation centers, counseling and support groups, medical and health centers, and indigent care as well as the more mainstream functions of religious education and worship services. Administrators and members can know the receipts and expenditures for each of these ministries when a fund accounting system is employed.

The Accrual Basis

While very few churches may realistically need a full accrual basis accounting system, some churches have grown beyond their church building and community.

With the aid of radio, television, and satellite communication systems, some churches have taken their ministries to regional, national, and international audiences. Such organizations have grown beyond the definition of a local church and may need special reporting procedures. The finances of such organizations are obviously large, when compared to other churches, and may be large even when compared to many commercial businesses. For the protection of the administrators and for the knowledge of the supporters of this size of religious organization, a highly sophisticated, well-organized accounting system that includes many accrual-basis procedures may be the most appropriate. Independent audits of the financial reports of this type religious organization would be appropriate. These organizations are not regulated or taxed by governments and, therefore, would be well served by demonstrating good accounting control systems and financial reporting activities.

The degree of simplicity or sophistication of the system depends upon the individual church.

The Appropriate Basis

Business management literature addresses the contingency approach to management; that is, that management style and procedures are contingent upon the needs peculiar to the individual business. Perhaps in church

accounting, the contingency approach is also appropriate. The accounting basis and system used by a particular church must be contingent on the size, ministries, wealth, financial and accounting sophistication of the membership and financial supporters. No accounting system is automatically appropriate for a particular church. However, a loose, unorganized, not well thought through system with weak internal control is inappropriate for any church organization.

Objectives of Church Financial Statements

The financial reporting of not-for-profit organizations should provide information that is useful to present and potential resource providers and other users in making rational decisions about the allocation of resources to those organizations [FASB, 1980]. The information should be comprehensible to those who have a reasonable understanding of an organization's activities and are willing to study the information with reasonable diligence.

The financial reports should also provide information to help users assess the services provided and the ability to continue to provide these services. This information is important because the services are the end product of the revenues. The relationship of the services provided to the resources used helps church members and others assess the extent to which the organization is successful in carrying out its objectives.

A church organization cannot, in the long run, continue to achieve its operating objectives unless the resources made available at least equal the revenues needed to provide services. Thus, church

members tend to direct their interest to information about the church's resources and how they are acquired and used. The focus of reporting is the church organization's performance and how its managers have discharged their stewardship responsibility during a period. Staff members of the church are accountable to

church members and other contributors, not only for the custody and safekeeping of church resources, but also for their efficient and effective use. Those who provide resources must look to the church staff to represent their interest and to make operating cost/benefit judgments that achieve the objectives of the church ►

THE CHURCH Comparative Combined Balance Sheet All Funds

ASSETS	December 31, 1987	December 31, 1986
Cash in Bank		
Combined bank account	\$ 23,921	\$ 16,937
Savings accounts, etc.	44,020	72,564
Total Cash	<u>67,941</u>	<u>89,501</u>
Land, Buildings and Equipment (at cost):		
New Sanctuary	851,190	851,190
Old Sanctuary and Sunday School Annex	329,092	285,184
Improvements in progress	-	9,791
Other buildings	169,267	169,267
Equipment (at estimated cost)	237,083	216,651
Parking lot and land improvements	43,628	30,173
Land (approximately 11 acres)	257,200	257,200
Total Land, Buildings and Equipment	<u>1,887,460</u>	<u>1,819,456</u>
TOTAL ASSETS	<u><u>\$1,955,401</u></u>	<u><u>\$1,908,957</u></u>
LIABILITIES AND EQUITY		
Liabilities		
Note payable — First National Bank	\$ 574,101	\$ 633,682
Note payable — Second National Bank — van	15,120	11,582
Total Liabilities	<u>589,221</u>	<u>645,264</u>
Equity	<u>1,366,180</u>	<u>1,263,693</u>
TOTAL LIABILITIES AND EQUITY	<u><u>\$1,955,401</u></u>	<u><u>\$1,908,957</u></u>

THE CHURCH

Comparative Statement of Cash Receipts and Disbursements and Changes in Cash Position For the Years Ended

	December 31, 1987	December 31, 1986
RECEIPTS		
Tithes	\$402,535	\$401,583
Special collections, revivals, etc.	6,064	8,467
Missions	20,032	22,179
Pledges (stewardship, etc.)	4,610	23,383
Sunday School	5,170	5,125
Interest income on savings	3,861	3,271
Miscellaneous offerings	14,559	29,196
Total Receipts	\$ 456,831	\$ 493,204
DISBURSEMENTS		
SALARIES AND BENEFITS	\$(163,862)	\$(162,675)
MAINTENANCE AND OPERATION OF BUILDINGS		
Janitorial and cleaning supplies	\$ 3,045	\$ 3,707
Maintenance and repairs	10,126	13,739
Church utilities	10,071	14,949
Church note — First National Bank	94,600	76,294
Insurance	10,379	11,591
Total Maintenance and Operation of Buildings	(128,221)	(120,280)
ADMINISTRATIVE AND OUTREACH		
Office supplies and other expenses	\$ 26,053	\$ 32,658
Flowers, books, benevolence	4,706	4,969
Printing	513	1,917
Awards, meetings, travel	400	1,584
Advertising and outreach	5,148	10,861
Total Administrative and Outreach	(36,820)	(51,989)
DEPARTMENTAL EXPENSES		
Sunday School supplies	\$ 5,117	\$ 5,973
Choir supplies	11,133	13,427
Youth Department	4,801	5,131
Revival, special speakers, etc.	3,286	10,890
Missions	33,869	33,324
Women's Department	14	120
Men's Department	-	712
Youth Ministries	778	1,448
Van expense of operation and note payments	8,384	10,086
Total Departmental Expenses	(67,382)	(81,111)
Total Disbursements	\$(396,285)	\$(416,055)
EXCESS RECEIPTS OVER OPERATIONAL DISBURSEMENTS	\$ 60,546	\$ 77,149
CAPITAL EXPENDITURES (Not Included Above)		
Fellowship hall and kitchen renovations	\$ 34,118	\$ 9,791
Parking lot and land improvements	13,455	2,960
Equipment and furnishings — new building	-	16,809
Van pay-off	10,413	-
Equipment purchased	2,437	-
Total Capital Expenditures	60,423	29,560
TOTAL RECEIPTS IN EXCESS OF DISBURSEMENTS	\$ 123	\$ 47,589

with a minimum use of resources.

Church Reporting Practices

The format and terminology of church financial statements should match the understanding of church members as well as focus attention on the church's primary activities. Common questions of members might include: how much cash is on hand, how do cash receipts compare with amounts pledged, what is the amount of unpaid bills, and what is the remaining balance on the mortgage, if any. Thus, some type of balance sheet and an activity statement are usually prepared. A sample set of financial

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statements is shown. These statements, prepared on a cash basis, show one form of presentation for the balance sheet and activity statement.

Balance Sheet. The balance sheet shown is comparative and the elements have very few classifications. For assets, only cash in the bank and land, building and equipment are presented. Liabilities are not classified as short or long term, and the equity section is not classified.

If accounts had been maintained on an accrual basis, accounts or pledges receivable would be reported on the balance sheet. Pledges would be recorded as receivables that are enforceable. (The legal right to enforce

collection is the important aspect of reporting the assets and not the church's willingness or ability to take legal action.) Accordingly, an allowance account would be established to provide for possible losses.

Activity Statement. The statement of activity is presented in many variations, differing in terminology, classifications, and format, but all contain basically the same information. One form of presentation for the operating statement shows the total amounts of revenues and expenses with extensions to either a support or program column. Another variation incorporates a comparison of budgeted and actual amounts. Regardless of the form of presentation, the basis of accounting upon which the statements are prepared should be made clear to the church's financial supporters.

The illustrative statement of activity classifies expenses as salaries and benefits, maintenance

and operations of buildings, administration and outreach, departmental and capital expenditures. The expense classifications are further subclassified for the type of cost incurred. This statement is also shown on a comparative basis.

Summary

As seen by accountants, churches have a unique problem. All churches offer the same basic services and acquire revenues in the same manner; however, standardization of the accounting and reporting of these entities is virtually impossible. Since churches differ in size, organization, finances, the educational level of membership, and other aspects, different accounting practices are necessary to convey relevant financial information. The authors advocate a contingency approach for accountants to determine what accounting and reporting practices

achieve the church's needs and goals. Under this approach, the church's accountant and administration would select a basis of accounting and a form of reporting. When a selection must be made from various alternatives, the accountant's and church administration's judgment is still what is best for each church.

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