

ARCHDIOCESE OF SEATTLE

SECTION C

PARISH ACCOUNTING CONCEPTS

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SECTION C: PARISH ACCOUNTING CONCEPTS

ACCOUNTING DEFINITIONS

Before we can effectively discuss concepts and learn procedures, we must define the basic terms underlying financial record-keeping.

| | |
|---------------|---|
| ASSETS: | <p><u>Things of value that are owned by the parish.</u></p> <p>Assets are the <i>resources</i> of the parish. Examples are cash, accounts receivables, prepaid assets, inventory, investments, land, building and equipment.</p> |
| LIABILITIES: | <p><u>Amounts owed by the parish to others.</u></p> <p>Liabilities represent <i>claims against the resources</i> (assets) of the parish. Examples include unpaid utility bills, taxes withheld from employee wages (owed to the IRS), outstanding loan balances, custodial collections not yet forwarded to the Archdiocese, and other accrued liabilities such as priest pension.</p> |
| FUND BALANCE: | <p>The difference between Assets and Liabilities. Also sometimes referred to as "Net Assets".</p> <p style="text-align: center;">Fund Balance = Assets – Liabilities</p> <p>The Fund Balance amount gives us, at a glance, some indication of past parish performance. The Fund Balance represents the cumulative total amount of financial results (revenues minus expenses) for all prior years. This number (the difference between revenue and expenses) balances the Statement of Financial Position (Balance Sheet).</p> <p>The parish may have other fund balances to show unrestricted, restricted, and designated fund balances. It is recommended that the parish show Capital Fund and Endowment Fund balances separately from the Operating Fund balance.</p> |
| REVENUES: | <p><u>The items which create an economic benefit to the parish.</u></p> <p>Generally, this is any time the parish receives money that it is not expected to pay back. Sunday collections are the most obvious example. Other examples of revenues are donations, fundraising receipts, tuition and registration fees, business income. Under some circumstances, non-cash items can create revenue (i.e. in-kind donations).</p> |

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| | |
|----------------------------------|---|
| EXPENSES: | <p><u>The economic costs of operating a parish.</u></p> <p>There are many costs of running a parish. Expenses can be broken down into <u>operating expenses</u> and <u>capital expenses</u>.</p> <ul style="list-style-type: none"> ▪ Operating expenses are expenses required in running the day-to-day operations of the parish. Examples are staff salaries, supplies, utilities, and maintenance costs. ▪ Capital expenses are amounts spent to acquire or improve long-term assets such as buildings and equipment. Note that these are not really expenses but increases to the asset value. |
| STATEMENT OF FINANCIAL POSITION: | <p>(Previously termed “Balance Sheet”) One of the primary financial reports, this statement is used to evaluate the financial position of the parish at a specific point in time. The Statement of Financial Position is a listing of parish assets, liabilities, and fund balances. It shows all of the resources of the parish (assets) and all of the claims against those resources (liabilities). Reviewing a Statement of Financial Position may give an indication of the financial health, stability, or well-being of the parish.</p> |
| STATEMENT OF ACTIVITIES: | <p>(Previously termed “Income Statement” or “Profit and Loss (P&L) Statement) The second primary financial statement reports the financial activities (revenues and expenses) of the parish over a period of time. It is used to evaluate the <u>financial operations</u> of the parish over a period of time (usually month or fiscal year).</p> <p>It is important to note that there is a fundamental inter-relationship between the Statement of Financial Position and the Statement of Activities. The difference between revenues and expenses is the amount which rolls forward to the Fund Balance section of the Statement of Financial Position.</p> <p>Capital expenditures, which may be quite material, will not be reflected within the Statement of Activities, but rather as an increase in assets on the Statement of Financial Position.</p> |
| STATEMENT OF CASH FLOWS: | <p>This is the final primary financial report. This statement details the impact on parish cash balances from income, expenditures and changes in assets and liabilities.</p> |

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RECORD KEEPING JOURNALS

In this section we will discuss journals as maintained in a manual / non-computer accounting system. The journals exist in a computer system, but their creation is much simpler -- the computer spreads the amounts to categories based on the GL (general ledger) account numbers entered with each transaction. It is important that users of computerized systems understand the theory behind the entries they make.

There are three record keeping journals that we will be discussing:

1. Cash Receipts Journal
2. Cash Disbursements Journal (check book)
3. General Journal



books of original entry

The books of original entry are the first place parish financial information is recorded. Indeed, writing checks and depositing money is the starting point for the accumulation of all financial information. Individual revenue and expense items are initially allocated, or *spread*, to various revenue and expense accounts in these journals.

Cash Receipts Journal

The Cash Receipts journal typically has several columns. This allows the user to allocate cash receipts to one of several revenue accounts, depending upon the nature of the revenue source. This journal allows for the recording of the date of each receipt, as well as a description of the source.

Cash Disbursements Journal

The Cash Disbursements Journal also has several columns for use in allocating expenses to various accounts. Besides columns for individual expenditure accounts, the checkbook will have columns in which to record the date, check number, the amount of the check, and the current cash balance in the account.

This journal is also the place to record *transfers* of cash from one cash account to another (e.g. checking to PRF savings). Remember: ***transfers of cash from one account to another do not represent revenue.***

As we said, the Cash Receipts and Disbursements journals are the initial recording place of financial information. The *totals* for each revenue and expense account, for each month (or each batch in a computerized system) are then transferred, or ***posted***, to the General Ledger.

General Journal

Both the Cash Receipts and Cash Disbursements are used to record actual cash transactions. The General Journal, on the other hand, is used to record transactions that may not necessarily result from the transfer of cash. These include entries to:

1. Adjust individual accounts (both the Statement of Financial Position and the Statement of Activities accounts)
2. Correct previous errors
3. Record previously unknown information
4. Enter non-cash financial transactions.

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For example, when the savings account statement is received indicating that interest has been earned, an adjustment needs to be made to record this information. Since the additional money in the account is not supported by a cash receipt or deposit slip, we make an adjustment to the books by increasing both accounts Cash in Savings and Interest Income by the amount of the interest earned.

The General Journal, or “GJ”, consists of columns for debits and credits, the date of entry, and a description. Adjustments to account balances are made, or **journalized**, within the GJ and then **posted** to the General Ledger just like receipts and disbursements.

GENERAL LEDGER

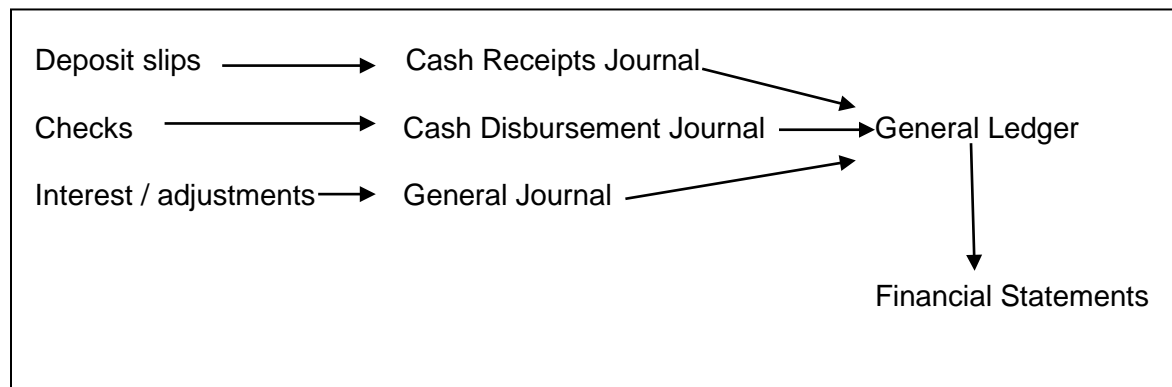
Ultimately, when we talk about “the books”, we are referring to the General Ledger, or “GL”. Since all other record keeping journals flow into it, the General Ledger represents the summarization of all financial information. Account balances from the GL are summarized on the Financial Statements.

In a manual system, the format of the GL has a page for every account (asset, liability, fund balance, revenue, and expense). Each account will have monthly **postings** that either add to or subtract from the previous balance. These postings will generally be monthly totals from the Cash Receipts and Disbursements Journals or individual adjustments from the General Journal. Rather than have an addition to the Office Supplies account for every purchase, the Office Supplies account page will have only the totals for each month added to the previous balance. Thus, this page will have a current, running balance of the year’s Office Supplies purchases.

To recap, expense and revenue information flows from the Cash Disbursement and Cash Receipt journals to the General Ledger where the monthly account totals are posted. Then, as needed, adjustments are made in the General Journal to correct or update individual account balances.

We can retrace our steps from the Financial Statements to the General Ledger, back to the General Journal, Cash Receipts and Disbursements journals, and finally back to the original checks and deposit slips. This is called the **audit trail**. Since at each stage we are summarizing the financial information more and more, it is necessary to trace back to our original information should we ever need to verify the information.

Audit Trail



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DOUBLE ENTRY ACCOUNTING

What is double-entry accounting and why do we need it? First, it is not double-work! It is a system that helps to maintain the accuracy of financial records (or books). Through a system of checks and balances, double-entry bookkeeping helps ensure the integrity of the books.

The primary characteristic of double-entry bookkeeping is the incorporation of parish assets and liabilities (Statement of Financial Position items) into the financial records. Double-entry recognizes the essential inter-relationships between Statement of Financial Position items (assets, liabilities, and fund balance) and Statement of Activities items (revenues and expenses). *Bookkeeping systems that do not incorporate Statement of Financial Position items are not incorrect, they are incomplete.*

The basic principle of double-entry accounting is that every transaction, or financial event, has a dual nature. That is, with any given transaction, two things occur. For example, when a parishioner gives the parish \$100, two things have happened to the parish; the parish's cash balance has increased by \$100, and the parish has received \$100 of revenue.

To take another example, suppose the parish writes a \$50 check to the office supply store for supplies. Again, two things have happened: the amount of cash in the checking account has decreased (by \$50) and the total spent on the office supplies for the year has increased (by \$50).

Note that we are thinking in terms of *account balances*. In the first example, the cash in checking balance has increased as has the revenue account balance. In the second example, the cash in checking balance has decreased as the office supplies expense account balance has increased.

Learning to think of transactions in terms of their dual nature is one of the important keys to understanding double-entry bookkeeping.

DEBITS and CREDITS

The other key is learning to associate certain *types of accounts* with certain *types of account balances*. When we discuss *types of account balances*, we're talking about whether an individual account has a *debit* or *credit* balance.

Types of accounts are associated with debit and credit balances. Debit accounts are: Assets and Expenses. Credit accounts are Liabilities, Fund Balances, and Revenues.

| Debit Accounts | Credit Accounts |
|---|--|
| <ul style="list-style-type: none">▪ Assets▪ Expenses | <ul style="list-style-type: none">▪ Liabilities▪ Fund Balances▪ Revenues |

Debits and credits should not be associated with being either "good" or "bad". For our procedural purposes, they are simply debit balances or credit balances.

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This is where the “double entry” part comes into play. Each transaction or event has a dual nature. For bookkeeping purposes, every event generates at least one debit and at least one credit. In any transaction, the debit(s) must equal the credit(s).

As we said, assets have debit balances. If we have \$100 in our checking account (cash is an asset), we have a \$100 *debit* balance in that account. If we receive \$50, we would *debit the account* with \$50; this would give us a \$150 debit balance in the account. Now, let’s assume that we write a check for \$25, thus decreasing the balance. We then have *credited* this account for \$25.

The chart below summarizes these Debit Account transactions:

| CHECKING ACCOUNT | | |
|------------------------|---|--------|
| | Debit Balance | 100.00 |
| Deposit \$50 | Debit the account \$50 (<i>Increase</i>) | 50.00 |
| | Debit Balance | 150.00 |
| Write a check for \$25 | Credit the account \$25 (<i>Decrease</i>) | 25.00 |
| | Debit Balance | 125.00 |

Credit accounts are the same. Let’s start with the revenue account, Donations, and assume that it’s the beginning of the year, so the balance in the Donations revenue account is zero.

A parishioner donates \$1,000. When the money is received, the Donations (revenue) account is *credited*, giving us a \$1,000 credit balance. At the same time, the Cash (asset) account has been increased or *debited* by \$1,000.

Next, assume that another parishioner donates \$500. Again, we credit the Donations revenue account for \$500; this gives us a \$1,500 credit balance. Starting with zero, we added a credit of \$1,000, then added a credit of \$500 to total a \$1,500 credit balance.

The chart below summarizes these Credit Account transactions:

| DONATION REVENUE | | |
|--------------------------|---|----------|
| | Beginning Balance at 7/1/XX | 0 |
| Gift of \$1,000 received | Credit the account \$1,000 (<i>Increased</i>) | 1,000.00 |
| | Credit Balance | 1,000.00 |
| Gift of \$500 received | Credit the account \$500 (<i>Increased</i>) | 500.00 |
| | Credit Balance | 1,500.00 |

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The following chart summarizes the concept of “types of accounts”:

| | |
|--|---|
| <p><u>DEBITS (Assets, Expenditures):</u></p> <ul style="list-style-type: none">➤ Increase an asset➤ Increase an expenditure account➤ Decrease a liability➤ Decrease a fund balance account➤ Decrease a revenue account | <p><u>CREDITS (Liabilities, Fund Balances, Revenues):</u></p> <ul style="list-style-type: none">➤ Increase a liability➤ Increase a fund balance account➤ Increase a revenue account➤ Decrease an asset➤ Decrease an expenditure account |
|--|---|

Note: The terms “debit” and “credit” can be nouns, verbs, or adjectives. That is, we can record a debit (a debit being a type of change that an account balance may experience), we can debit an account (which is the act of changing the account balance), or we can describe an asset account as being a debit account (describes a noun).

So far we’ve talked about debits and credits, but we haven’t really talked about them together. As we’ve said, every transaction has a dual (or double) nature, and includes at least one debit and at least one credit. The most fundamental idea in double entry accounting is that the debits and credits generated from every transaction must balance each other. That is the key to just about everything that we’ll be discussing.

The section we just finished covers some of the most important concepts in double entry accounting. To recap:

- Debit accounts are either assets or expenditures.
- Debits increase debit accounts and decrease credit accounts.
- Debits always equal credits

- Credits accounts are liabilities, fund balances, and revenues
- Credits increase credit accounts and decrease debit accounts
- Credits always equal debits

Your Bank’s Perspective on debits / credits:

You will note that the bank occasionally sends you a notice that they are “crediting” your account, or adding money to it, usually as a result of interest earned or an error. Since we know that we need to debit our account in order to increase it, this is likely to cause some confusion. Here’s why:

To the bank, your account is a *liability*, not an asset. It is an asset to you. So, when you make a deposit, you are *debiting* your books while the bank is *crediting* theirs. Likewise, when you make a withdrawal, you are crediting your account while the bank is debiting your account.

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So far, we've been dealing with all this in a rather theoretical fashion. Let's consider something more familiar, in this case a cash disbursements journal (or checkbook). The following are month end totals from a cash disbursements journal:

| ACCT # | DESCRIPTION | AMOUNT |
|--------|---------------------------|-----------------|
| 5101 | Clergy Salary | 500.00 |
| 5121 | Bookkeeper Salary | 1,000.00 |
| 5502 | Office Supplies | 850.00 |
| 6180 | Fund Raising Expense | 300.00 |
| 6301 | Combined Utilities | 925.00 |
| 2301 | PRF loan | 750.00 |
| | TOTAL EXPENDITURES | 4,325.00 |

These are the totals of all checks that have been written for the month. Since these amounts are all expenditures, they are by definition, debits. Checks represent a reduction in cash, an asset. The way to reduce an asset (a debit) account is with a credit. So the debits for this series of transactions are listed above and the credit is to the Cash Account, which reduces the cash balance by \$4,325.00.

Note: You may notice that, unlike the other expenditures which have 5000 or 6000 account numbers, the PRF Loan has a 2300 account number. This, of course, denotes that the PRF Loan is a liability. Liabilities are credit accounts, and the \$750 expenditure is a debit, which decreases the credit balance.

The Cash Receipts Journal is similar to the Cash Disbursement Journal above. The CR journal has a column for the total receipt as well as columns to record the various types of revenue that you receive. Each of the revenue columns represents a *credit*, increasing revenue. The column for recording the total receipts represents the increase in the cash balance, or the *debit*.

We're now going to start working through this section by thinking in terms of transactions and their related debits and credits. We'll be presenting transactions using a standardized **journal entry** format. That is, instead of working from simulated cash receipt and disbursement journals, we will use the form of a journal entry (to be explained and discussed later) to more easily illustrate individual transactions.

The following transaction represents the purchase of office supplies.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|---|------------------|-------|--------|
| 5502 | Office Supplies | 75.00 | |
| 1115 | Cash in Checking | | 75.00 |
| To record the purchase of office supplies | | | |

Some things to note: The debit is always the first entry, and is recorded in the left-hand column; the credit is always shown as the second entry and is placed in the right-hand column. Any one transaction or journal entry may be comprised of several debits or credits, but the totals of all of them must balance. It is also customary to include a short description of the transaction.

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As you can see, the point of the double-entry system is that for every debit, there is a corresponding credit and, thus, the accounting records will always be in balance. **The importance of including assets, liabilities, and fund balances (Statement of Financial Position items) in the accounting records cannot be overemphasized.** These accounts, in conjunction with the double-entry method, provide for a check against the accuracy of the records as a whole. In addition, viewing or thinking of individual transactions in this format helps emphasize the necessity of balancing debits and credits.

It is important now to revisit the distinction between the recording of transactions and journal entries.

Transaction: Each time a check is written or a deposit is made, a transaction has taken place. When the parish writes a check to the office supply store for typing paper, the transaction includes an increase in the total amount spent on office supplies for the year and a decrease in the amount of cash in the bank. When a deposit is made of the Sunday Collections, the transaction is the increase in the total revenue for the year and the corresponding increase in cash.

Journal Entry: A journal entry is a tool used to adjust ending balances through the General Journal. Thus, a journal entry might be used to correct an error made earlier in the year, or to record new information such as the specific amount of the monthly bank fee, or the amount of interest paid on a bank loan during the year.

By way of explanation, let's look at the following example:

TRANSACTIONS

| ACCT # | DESCRIPTION | EXPENDITURE | REVENUE |
|--------|-----------------------------|------------------|------------------|
| 5101 | Clergy Salary | 7,000.00 | |
| 5121 | Bookkeeper Salary | 9,000.00 | |
| 5502 | Office Supplies | 4,300.00 | |
| 2301 | PRF Loan | 2,500.00 | |
| 6180 | Fund Raising Expenses | 800.00 | |
| 6301 | Combined Utilities | 1,150.00 | |
| 4101 | Sunday Envelope Collections | | 25,000.00 |
| 4401 | Donations | | 1,000.00 |
| 4530 | Rental Income | | 250.00 |
| | TOTAL | <u>24,750.00</u> | <u>26,250.00</u> |

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While these transactions have already occurred, they will need to be “posted” to the General Ledger in the form of the following two journal entries.

JOURNAL ENTRY

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|--------|------------------------------|----------|-----------|
| 5101 | Clergy Salary | 7,000.00 | |
| 5121 | Bookkeeper | 9,000.00 | |
| 5502 | Office Supplies | 4,300.00 | |
| 2301 | PRF Loan | 2,500.00 | |
| 6180 | Fund Raising Expenses | 800.00 | |
| 6301 | Combined Utilities | 1,150.00 | |
| 1115 | Cash in Parish Checking Acct | | 24,750.00 |

To record the year’s checking account transactions.

JOURNAL ENTRY

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|--------|-------------------------|-----------|-----------|
| 1115 | Cash in Parish Checking | 26,250.00 | |
| 4101 | Sunday Collections | | 25,000.00 |
| 4401 | Donations | | 1,000.00 |
| 4530 | Rental Income | | 250.00 |

To record the parish’s total income for the year.

Note: the journal entries are for illustrative purposes. Normally, the posting would be done from the Cash Receipts (CR) and Cash Disbursements (CD) journals

Remember, the debits in this case are:

- increasing asset accounts (Cash in Checking),
- decreasing liability accounts (PRF Loan), and
- increasing expenditure accounts (Salaries, etc.)

...while the credits are

- decreasing asset accounts (Cash in Checking) and
- increasing revenue accounts (Sunday Collections, etc.).

As usual, there are several adjustments necessary to bring the books to the correct balances.

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Assume the following adjustments are required:

1. \$1,250.00 of the PRF Loan payments represent the interest portion.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|---|------------------------|----------|----------|
| 6105 | Interest Expense – PRF | 1,250.00 | |
| 2301 | PRF Loan | | 1,250.00 |
| To adjust PRF Loan principal payments to actual and to record the related interest expense. (This type of entry will normally be made quarterly, when the PRF Loan statement is received, but may also be made at the yearend). | | | |

2. Unrecorded bank charges for the year amount to \$55.00.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|---|---------------------------|-------|--------|
| 6101 | Bank Charges | 55.00 | |
| 1115 | Cash in checking – Parish | | 55.00 |
| To adjust the checking account balance to actual and to record bank charges. This entry is normally made when the bank statement is received. (This entry is necessary to bring the parish books' checking account balance to the actual; if the bank charges have not been recorded, then the balance per the books will be overstated by the \$55.00) | | | |

3. Originally recorded as Rental Income, \$150.00 was miscoded and should have been recorded as Interest Income.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|--|-----------------------|--------|--------|
| 4530 | Rental Income | 150.00 | |
| 4501 | Interest Income - PRF | | 150.00 |
| To record interest income that was credited to Rental Income by error. (This represents an entry to correct a prior error. Note that by debiting the Rental Income account, we are decreasing it in order to increase the Interest Account.) | | | |

To summarize, journal entries are made to correct errors and to adjust account balances to their actual or correct balance. Each transaction and journal entry must include both debits and credits which must balance when totaled. In addition, each recorded journal entry must include a short explanation below it, which summarizes the transaction and explains the reason for it.

At the beginning of the fiscal year, before any revenue or expenditures have been recorded, the Statement of Financial Position items (assets, liabilities, and fund balances) conform to the following:

$$\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCES}$$

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As the year's transactions are recorded, the Statement of Financial Position items will not balance. The reason is that any given transaction may have an effect on a Statement of Financial Position item and a revenue or expense account. For example, when office supplies are purchased, cash is decreased (a credit) and the supplies expenditure account is increased (a debit). So one Statement of Financial Position account has changed, as has one of the Statement of Activities accounts.

The difference between the debits and credits for the Statement of Financial Position accounts (assets and liabilities / fund balances) will equal the difference between the debits and credits for the Statement of Activities accounts (revenues and expenditures):

ASSETS + EXPENDITURES = LIABILITIES + FUND BALANCES + REVENUES

OR

REVENUES – EXPENDITURES = ASSETS – LIABILITIES – FUND BALANCES

For each parish program (parish operations, religious education, school, cemetery), there are related revenues and expenditures. At the end of the fiscal year, the sum of the differences between revenues and expenditures for all parish activities will be the figure that makes the Statement of Financial Position balance.

More on Receipts and Disbursements:

When Cash is *received*, four possible things can happen:

1. Revenue is earned (e.g. donations)
2. A liability has been incurred (e.g. new loan)
3. An expenditure has decreased (e.g. refund or reimbursement)
4. An asset has decreased (e.g. sale of an asset) *See Section D.*

When cash is *spent*, four possibilities also exist:

1. An expense is increased (e.g. a bill is paid)
2. A liability decreases (e.g. debt payment)
3. Revenue is decreased (e.g. refund or reimbursement)
4. An asset is increased (e.g. a purchase)

Note: If cash is received as a reimbursement for either returned goods or an overpayment of a bill, it is preferable to credit (or reduce) the amount in the expenditure account by the amount of the reimbursement rather than crediting a revenue account. This is called "offsetting", and is recommended because it better reflects the economic reality of the transaction.

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RECEIVABLES, PAYABLES, and ACCRUAL ACCOUNTING

One of the goals of accounting is to match, as best we can, revenues and expenditures with the accounting period (generally, fiscal year) to which they relate. To accomplish this, we use several accounts and the concept of Accrual Accounting.

Accounts Receivables

In general, parishes do not encounter receivables, although schools sometimes do.

Accounts Payable

Accounts Payable are amounts owed by the parish. Every organization has Accounts Payable, be they outstanding bills or payroll taxes withheld. We must determine whether or not to formally record them within our financial records.

The recording of the payroll tax liability resulting from the proper withholding procedures is absolutely necessary to ensure accurate accounting. The withholding procedures (discussed in Payroll, Section D) provide us with assurance that the amount remitted to the IRS is correct.

Accrual Accounting

Whether, or to what extent, we accrue is referred to as our *basis of accounting*. There are several methods (basis) of maintaining financial records.

Cash Basis

Under the cash basis of accounting, revenue is recorded when cash is received, and expenses are recorded only when cash is spent. For some parishes, cash basis accounting is quite adequate. If the parish is using the cash basis of accounting, there would be no need to record accounts payable or receivables. Payroll and all other expenses would be recorded when paid. Revenue amounts would be recorded when received.

Accrual Basis

Under the accrual method, revenue is recorded when earned regardless of when it is collected, and an expense is recorded when incurred regardless of when it is paid. If the parish is using this method, it would record accrued expenses, accounts payable and receivable. Using the accrual method is more time-consuming and complex than the cash basis.

Modified Accrual Basis

There is a third option available and acceptable for recording your transactions known as the modified accrual basis. The distinction is that only specific items are accrued. It is extremely important to record some items within the accounting records in order to provide better control, accurate reporting, and budgeting. **Modified accrual is the preferred basis of accounting under the Parish Accounting System.**

YEAR-END or MONTH-END ACCRUALS

If a parish wants its reports on the accrual basis of accounting, it will have to adjust its accounts at year or month-end (depending on the preference of the parish) to reflect accrued amounts. Accrued liabilities or accrued expenses are amounts a parish owes or has incurred but has not yet paid or recorded. Examples of accrued liabilities include salaries and wages earned by employees but not yet paid (Salaries Payable, other Payroll Payables) and interest owed on debt (Interest Payable).

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FUND BALANCE ACCOUNT

The Fund Balance account is the sum total of all parish income (revenues minus expenses) for all prior years of the parish.

At the beginning of any fiscal year, the Fund Balance account is also the difference between the total assets and total liabilities. The Statement of Financial Position is made up of three things:

- Things we own (assets)
- Things we owe (liabilities)
- Income that we've made in the past (fund balance)

Again, the basic accounting equation:

$$\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE}$$

Here's a quick illustration to explain where the fund balance account amount comes from. Assume the following information: for each of the first three years of parish operation, the parish has revenues that exceed expenses by \$10,000.

| | YEAR 1 | YEAR 2 | YEAR 3 |
|---|---------------|---------------|---------------|
| Total Revenues | 100,000 | 100,000 | 100,000 |
| Total Expenses | <u>90,000</u> | <u>90,000</u> | <u>90,000</u> |
| Revenues – Expenses (<i>surplus</i>) | 10,000 | 10,000 | 10,000 |
| Ending Fund Balance | 10,000 | 20,000 | 30,000 |

As you can see, every year the parish earns a “*surplus*” (revenues minus expenses) of \$10,000. Over the course of three years, the total ending fund balance amount has increased to \$30,000. As we said, the fund balance account is the sum total of all parish income (revenues minus expenses) for all prior years of the parish.

Perhaps the best way to explain the fund balance account and how all this ties together is to start with an example. For this example, we'll start with a brand new parish.

The first event is a fund raiser. The event raises \$10,000. So now, the parish financial statements look like this:

STATEMENT OF ACTIVITIES (or Profit & Loss Statement or Income Statement)

| | | | |
|----------------------------|----------------------|--------|-----------------|
| REVENUES | | | |
| | Fund Raising Revenue | 10,000 | |
| | Total Revenue | | 10,000 (credit) |
| EXPENDITURES | | 0 | |
| | Total Expenditures | | 0 |
| YEAR-T0-DATE NET INCOME | | | 10,000 (credit) |

ARCHDIOCESE OF SEATTLE

STATEMENT OF FINANCIAL POSITION (or Balance Sheet)

| | | | |
|-------------------------|------------------------------------|--------|----------------|
| ASSETS | | | |
| | Cash | 10,000 | |
| | Total Assets | | 10,000 (debit) |
| LIABILITIES | | 0 | |
| FUND BALANCE | | | |
| | Fund Balance | 0 | |
| | | 0 | |
| | | 0 | |
| | Total Liabilities and Fund Balance | | 0 |
| YEAR-TO-DATE NET INCOME | | | 10,000 (debit) |

As the result of this event, this parish now has an asset (cash) and revenue. The parish also has a *balanced* set of books; there is a debit of \$10,000 (cash) and a credit of \$10,000 (fundraising revenue).

The parish continues to grow and undertakes the following financial activities, (in journal entry format):

1. Parish takes out a loan for \$50,000.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|--|------------------|--------|--------|
| 1115 | Cash in checking | 50,000 | |
| 2301 | PRF Loan Payable | | 50,000 |
| To record the receipt of loan proceeds and the related liability | | | |

2. Parish leases space for \$15,000

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|-----------------------------|------------------|--------|--------|
| 5906 | Property Lease | 15,000 | |
| 1115 | Cash in Checking | | 15,000 |
| To record the lease expense | | | |

3. Parish buys a car, computer equipment, and office equipment for \$25,000

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|--|--------------------------------------|--------|--------|
| 1539 | Capital Purchase/ Equipment (car) | 8,500 | |
| 1535 | Capital Purchase/ Equipment (office) | 16,500 | |
| 1115 | Cash in Checking | | 25,000 |
| To record the purchase of a vehicle and office equipment | | | |

ARCHDIOCESE OF SEATTLE

4. Parish has a Sunday Envelope collection of \$45,000.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|---------------------------------|-------------------|--------|--------|
| 1115 | Cash in Checking | 45,000 | |
| 4101 | Sunday Collection | | 45,000 |
| To record the Sunday Collection | | | |

5. Parish spends \$8,000 making improvements to their leased facility.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|--|-----------------------|-------|--------|
| 5801 | Repairs & Maintenance | 8,000 | |
| 1115 | Cash in Checking | | 8,000 |
| To record renovations and repairs made to the building | | | |

The resulting Statement of Financial Position and Statement of Activities are listed on the next page.

STATEMENT OF ACTIVITIES

| | | | |
|------------------------------------|-----------------------------|---------------|--------|
| REVENUES | | | |
| | Sunday Envelope Collections | 45,000 | |
| | Fund Raising Revenue | <u>10,000</u> | |
| | Total Revenue | | 55,000 |
| EXPENDITURES | | 0 | |
| | Property Lease | 15,000 | |
| | Repairs / Maintenance | <u>8,000</u> | |
| | Total Expenditures | | 23,000 |
| YEAR-T0-DATE NET INCOME | | | 32,000 |

STATEMENT OF FINANCIAL POSITION

| | | | |
|------------------------------------|---------------------------------------|---------------|---------------|
| ASSETS | | | |
| | Cash | 57,000 | |
| | Equipment – vehicles | 8,500 | |
| | Equipment – office | <u>16,500</u> | |
| | Total Assets | | <u>82,000</u> |
| LIABILITIES | | 0 | |
| | PRF Loan | <u>50,000</u> | |
| | Total Liabilities | 50,000 | |
| FUND BALANCE | | | |
| | Fund Balance | 0 | |
| | Total Liabilities and Fund Balance | | <u>50,000</u> |
| YEAR-T0-DATE NET INCOME | | | <u>32,000</u> |

ARCHDIOCESE OF SEATTLE

Now, let's assume that these are the total of this parish's operations for the fiscal year. So, at year-end, we close out our revenue and expense accounts so that we may begin the next year with zero balances.

The year-end close-out procedure is actually quite simple. For each account with a debit balance, we credit the account by the amount of the balance; for each account with a credit balance, we debit the account by the amount of the balance. To illustrate, let's first look at our Statement of Activities account balances.

| ACCOUNT # | DESCRIPTION | DEBIT | CREDIT |
|-----------|-----------------------|---------------|---------------|
| 4101 | Sunday Collection | | 45,000 |
| 4310 | Fund Raising Projects | | <u>10,000</u> |
| 5906 | Property Lease | 15,000 | |
| 5801 | Repairs / Maintenance | <u>8,000</u> | |
| | TOTALS | <u>23,000</u> | <u>55,000</u> |

Now, we'll debit all of the credit balance accounts, credit away all of the debit balance accounts, and whatever the difference is, a debit or credit, we'll journalize to the Fund Balance Account.

From the balances listed above, we know that we have total credits of \$55,000 and total debits of \$23,000, a difference of \$32,000. Note that this is the same amount as Year-To-Date Surplus from the financial statements on the previous page.

Since we know the definition of Fund Balance to be "the sum total of all parish income (revenues minus expenses) for all prior years of the parish," we know that \$32,000 will be our new Fund Balance account balance. We also know that the Fund Balance account is a *credit* account.

| ACCT # | DESCRIPTION | DEBIT | CREDIT |
|---|-----------------------|--------|--------|
| 4101 | Sunday Collections | 45,000 | |
| 4310 | Fund Raising Projects | 10,000 | |
| 5906 | Property Lease | | 15,000 |
| 5801 | Repairs / Maintenance | | 8,000 |
| 3101 | Fund Balance | | 32,000 |
| To close-out the year-end revenue and expenditure balances to the Fund Balance account. | | | |

So, the year-end close-out was an adjustment, a journal entry that clears the old balances in our Statement of Activities accounts. We now can begin the new fiscal year. The total in the Fund Balance account, \$32,000, is the sum total of all parish income (revenues minus expenses) for all prior years for this parish.

ARCHDIOCESE OF SEATTLE

Our final Statement of Financial Position looks like this:

STATEMENT OF FINANCIAL POSITION

| | | | |
|--------------|------------------------------------|---------------|---------------|
| ASSETS | | | |
| | Cash | 57,000 | |
| | Equipment – vehicles | 8,500 | |
| | Equipment – office | <u>16,500</u> | |
| | Total Assets | | <u>82,000</u> |
| LIABILITIES | | 0 | |
| | PRF Loan Payable | <u>50,000</u> | |
| | Total Liabilities | 50,000 | |
| FUND BALANCE | | | |
| | Fund Balance | 32,000 | |
| | | | |
| | | | |
| | Total Liabilities and Fund Balance | | <u>82,000</u> |

Changes in Fund Balance

As we've seen on the preceding pages, the most common example of a *change in Fund Balance* occurs at year-end when the revenue and expense accounts are closed out and the year's net Income (or loss) is credited (or debited) to the account.

The only other reason for a change in a Fund Balance account would be the need to make an adjustment to the parish Statement of Financial Position. Adjustments to the Statement of Financial Position would be necessitated in cases where an error or omission has been made. In such instances, rather than make an adjustment directly to the Fund Balance account (#3101) it is appropriate to use an intermediary account called the Adjustment to Fund Balance account (#3103). The use of this account provides us with more of an **audit trail** than does making adjustments to the Fund Balance (#3101) account.

Adjustments of this nature should only be made in unusual circumstances. You should make a particular effort to maintain a paper **audit trail** for these entries.