

# Bookkeeping Basics

MINI-MANUAL FOR SMALL NON-PROFITS

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## I. Overview

Bookkeeping is most simply defined as the recording of financial transactions. I like to think of it as the care and feeding of an organization's financial records. A bookkeeper's responsibility is to keep the "books" (those financial records) as clean and healthy as possible, and to make sure the organization complies with what are known as Generally Accepted Accounting Practices (GAAP). There are several reasons to comply with GAAP:

- As a public charity, your organization should have a yearly audit or financial review. If your income is below a certain threshold, you aren't legally obligated to have an audit/review, but you should have one anyway. Among other things, auditors test your books to see if they comply with GAAP.
- Using GAAP year-round helps your accountant prepare your federal tax return, IRS Form 990. There can be dire consequences to not filing Form 990, from large fines to revocation of your nonprofit status.
- Using GAAP allows you to produce standard and consistent financial reports for your board and leadership. These reports are a crucial tool for guiding the organization.
- GAAP also provides security and oversight. If you don't use it, that chances that something funny will happen with your organization's money increase drastically.

The best way to keep clean records that adhere to GAAP is to use a monthly process that "closes the books" (also called closing the month). This is a sort of quick mini-audit that allows you to go through the entire finances of the company and make sure everything is ship-shape. It may take a little time to get your month-close process in place, but once you have it, you'll come to appreciate its usefulness.

If you are what's known as a full-charge bookkeeper, you'll be doing the monthly closes yourself; if the organization has an accountant or financial consultant, she may do it.

## II. Setting up the bookkeeping desk and files

The bookkeeping area needs only a few things to get up and running. One useful item is an inbox with different compartments; you can also use a standing file with different manila folders. You might use the following categories:

- Bills to process
- Bills ready to pay
- Deposits to process
- Bank statements
- Other bookkeeping to do

Paperwork can be slotted into these folders as it comes in.

You'll also need a file drawer – or several, depending on the size of your organization. Make space in the drawer for each of the following:

- *Accounts paid.* These are bills that have been paid, usually filed alphabetically by vendor name. For each bill, keep your check stub and all paper backup (the bill itself, vendor statements or correspondence, etc.).
- *Deposits.* These are usually filed by date. For each deposit, keep copies of the check(s), the deposit slip, the bank receipt, and the printed record of the deposit from your accounting software.
- *Bank reconciliations.* These are filed by month. Each time you reconcile a bank statement, print the report from your accounting software, attach the statement and file it here.
- *Workpapers.* Workpapers are the backup spreadsheets you create when you close the month. If your month close is at all complicated, it's best to keep printouts of each spreadsheet along with all supporting documentation. I file workpapers by type.
- *Payroll.* I'm including this here, though personally I prefer to store all payroll materials in a binder. Either way, you will be keeping timesheets and all internal communications for each payroll period, as well as the reports generated by your payroll service. Payroll is filed by date.

At the close of your fiscal year, clear out this drawer or start a new one. If you're moving files out of the drawer, be sure to keep them in good order in a banker's box or similar storage.

### III. Introduction to the chart of accounts

The chart of accounts is the main way you categorize your organization's finances. It's a list of all the categories your organization puts money into—both money it spends and money it receives. Under GAAP, every chart of accounts follows a certain format. Accounts are numbered and grouped by type, and the types always appear in the same order:

1. Assets: the 1000 numbers.
2. Liabilities: the 2000 numbers.
3. Equity: the 3000 numbers.
4. Income: the 4000 numbers.
5. Expenses: the 5000 numbers, going up to 6000 numbers if you've got a lot of them.

The first three types—assets, liabilities, and equity—are known as balance sheet accounts, because they appear on one of the two basic financial reports, the balance sheet. The last two types—income and expenses—are known as profit-and-loss accounts, because (as you can probably guess) they appear on the other basic report, the profit and loss.

To be greatly reductive, your job as bookkeeper mostly involves the profit-and-loss accounts. The balance-sheet accounts are used primarily during month close, and occasionally at other times to record non-routine transactions such as loans, prepayments, or deferred revenue.

One reason this view is reductive is that most financial transactions actually involve both types of accounts. For instance, when you record a bill you are posting (making a change) both to an expense account and to accounts payable, a liability. But your accounting software will automatically post to accounts payable, so all you need to worry about is choosing the right expense account.

In QuickBooks, the chart of accounts is not the only way to categorize transactions. You can also categorize them by choosing from a much shorter list of classes. Generally, classes are used to identify the program and/or grant associated with the transaction, which in turn aids tracking and analysis.

## **IV. Using the profit-and-loss accounts**

### ***Paying bills***

As a bookkeeper, one of your main jobs is paying for things the organization needs – supplies, space, utilities, contracted services, and so on. A standard process for paying bills is as follows:

1. Enter each vendor bill into the accounting software with the correct expense category (and class, if you use them).
2. Set the paperwork aside in your “Bills ready to pay” file.
3. When all bills are entered, run an accounts payable aging report. This shows you all the bills you owe and how long you have owed each one.
4. Review the report with your executive director or manager. Based on how much cash the organization has in the bank, choose bills to pay today.
5. Cut (print) checks for each of those bills.

### ***Running payroll***

Payroll can get complicated. It’s best to use a payroll service rather than risking tax problems by handling it yourself. Each of the big players, ADP and Paychex, has a nice web platform that makes transmitting payroll a fairly painless process.

The big job comes after payroll is transmitted. Your payroll service will generate a variety of reports showing who got paid what as well as what the organization is paying in taxes, fees, and retirement benefits (should you be lucky enough to have them). The information from these reports must be entered into your accounting software in a way that’s GAAP-compliant. You or your accountant can create a template in Excel to help you with this entry.

### ***Making deposits***

Usually, putting money in the bank for your organization is easy and fun. Your accounting software has a deposit screen that lets you assign an income account to each amount you receive. Deposits can get complicated in two ways: if the money is payment on an invoice you’ve generated for a customer or client, or if it’s from a restricted grant. In the former case, your software probably has another screen where you can record the invoice as paid. In the latter, consult your accountant to make sure you’re capturing everything she needs when you enter the deposit. She (or you) will be tracking the income and expense on this grant as part of month close.

## V. Using the balance-sheet accounts

As mentioned above, you don't need to think much about balance-sheet accounts when you're paying bills and making deposits. Assets, liabilities and equity are the "back end" of accounting – the stuff that goes on behind the curtain.

However, you do need to understand them to close the books. At a minimum, you should reconcile all bank accounts monthly. You may also want to create some Excel spreadsheets, called workpapers, that reconcile one or all of the following:

- Prepaid expenses
- Depreciation
- Restricted funds
- Accounts receivable
- Deferred revenue
- Accrued expenses
- Overhead allocation

Don't worry! Your financial consultant can explain each of these and work with you to develop a monthly close that suits your organization. She will also help you with audit prep, which is the grand close at the end of the year.

## VI. Financial reporting

Finally, we come to the point of all this bookkeeping – financial reports. Now that your records are pristine and your accounting software is up to date, you can produce monthly reports for your board and leadership. Here are some typical financial reports.

### ***Profit and loss; balance sheet***

You're already familiar with these terms from your work with the chart of accounts!

A *profit and loss* report, also called an income statement, shows how your organization fared over a certain period of time. It lists all income accounts and their balances (how much money has accumulated in each during the reporting period), followed by all expense accounts and their balances. At the bottom, it subtracts total expense from total income to show you how much money the organization made or lost during that time.

A *balance sheet*, unlike a P&L, is a snapshot of your organization's finances at a specific moment in time (usually the last day of the closing month). Also unlike a P&L, which shows a surplus or deficit in the bottom line, a balance sheet balances — that is, its top half equals its bottom half. At the top are your assets; at the bottom are your liabilities and equity (also called net assets). This represents the “accounting equation,” the famous concept that assets equal liabilities plus equity.

### ***Cash-flow projection***

A cash-flow projection is a variation on the profit and loss. Like the P&L, it shows income, expenses, and a bottom line; unlike the P&L, it is divided into months and shows estimated income and expense for future months. It also shows the effect of each month's estimated transactions on your bank balance. This is an invaluable tool for financial planning.

### ***Budget to actual***

Another great tool is the budget-to-actual report. This one also looks like the P&L, with income on the top and expense on the bottom. Alongside each account total, it lists the total budgeted for that account. Your software can also provide the difference in percentages and dollars.

### ***Dashboard***

Board members love dashboards, which help them digest the complicated financial information in your other reports. A dashboard is a compilation of various indicators of financial health; which ones you use depend on your organization. For example, you may want to show a breakdown of cash into restricted funds, unrestricted funds, and reserves; how many months of operating money the organization has in the bank; and/or a quick look at accounts payable and receivable.