

Don Kramer's A Newsletter of "Nonprofit Law You Need to Know"				Recent Issues
NONPROFIT ISSUES				Article Archives
				Ready Reference
				Talk to the Editor
				Books and Bundles
Home	FAQs/Site Map	Renew	Access Account	

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[Behind the Numbers](#)
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[Risk and Reward](#)
[Behind the Numbers](#)
[Tax Matters](#)
[To the Point](#)

[Site Map/FAQs](#)

[Features](#) >> [Behind the Numbers](#) >> [December 1-15, 2005](#)

BEHIND the NUMBERS

Your Chart-of-Accounts: The Key to Meeting Competing Needs For Financial Information

By Eric Frint, President

[Your Part-Time Controller, LLC](#)

Your nonprofit organization faces demands for financial reports from a variety of different constituencies including management, staff, board committees, funders, grantors, donors, auditors, bankers and the IRS. Many of these financial report readers require that your reports be presented in different formats. The question is: how do you set up your accounting system to satisfy all needs? If you set up your accounting system one way to make reporting easier for one set of statement readers, this often makes it harder to produce the required statements for other users.

The solution to this problem lies in the design of your organization's chart-of-accounts. A well-designed chart-of-accounts will provide your organization with the flexibility it needs to meet competing requests for financial information. This article will explain what a chart-of-accounts is and why a good chart design is important. I will then explain a systematic approach to developing a well-designed chart-of-accounts and present some cautions to prevent making a few common chart design mistakes.

The chart-of-accounts is the system you use in your accounting software for collecting and classifying financial transaction information. The chart determines how revenue, expenses, assets and liabilities are recorded and organized into separate buckets of information called accounts. The quantity, detail, and organizational structure of these accounts constitute your chart-of-accounts. You might think of your chart as an electronic file cabinet where each folder contains information for just one account such as cash or utility expense. You control the number of these accounts and the level of detail of each of them. For example, instead of a utility expense account you might decide to have additional accounts or detail accounts for each type of utility expense such as water, electricity and gas.

The structure of your chart dictates how well your accounting system will be able to pull together the information you need into meaningful Statements of Financial Position (Balance Sheets), Statements of Activity (Income Statements) and Cash Flow Statements. A well-designed chart will allow you to refine your data to a level of detail appropriate for your organization. It will enable you to produce financial reports by program, department, and funding source. It will be flexible enough to allow you to generate information for different funders and other users of your financial information. On the other hand, a poorly designed chart will obscure your financial performance and make any meaningful analysis of your financial performance difficult.

So what are some important chart design criteria? The first and most important consideration is for you to determine the number of segments your account structure should have and the length of each segment. Each account in your chart is designated by a number. This number is typically anywhere from four to fifteen digits and is broken up into segments. Each segment allows you to track a different area of your organization. Common chart segments include General Ledger account segment, a fund segment, program and sub-program segments, department segments, and funding source segments. Some organizations may add a segment to track different physical office locations, if applicable. The size of each segment is determined by the number of accounts your organization needs.

The General Ledger account segment, typically four or five digits long, is where you track your natural account classifications such as cash, receivables, grant revenue, salary expense, printing expense, etc. The fund segment, usually one or two digits long, allows you to track unrestricted and restricted funds, capital funds, and endowments. Program and subprogram segments allow you track revenue and expense by your programs. The program segment may have two or three digits depending on the number of programs your organization typically has in a given year. If you need to track by subprogram, add a one or two digit subprogram segment. If your organization has separate departments, and if tracking financial performance by department is important, add a program segment of one or two digits, depending on your number of departments. If tracking revenue and expense by funding source is required, add a segment of two or three digits depending on your number of funding sources.

The next step in designing your chart-of-accounts is to list and number your General Ledger accounts. A typical numbering scheme for these accounts would be for all asset accounts to start with the number one, all liability accounts to start with a two, net asset accounts with a three, revenue accounts with a four, and expenses with the number five or higher. When listing your accounts consider the level of detail you need. For example, one organization may want to have different salary expense accounts for each type of position in the organization such as salaries-development, salaries-executive director, and salaries-program staff. A different organization may decide that a single salary expense account is sufficient. Bear in mind that while more detail makes it possible to have financial reports with greater depth, the additional detail also makes your accounting more difficult.

The next step in this design process is to consider the suitability of your accounting software to accommodate your structure. Some accounting software packages limit the number of segments you may have and the size of each segment. If you discover you have this problem you have two choices: modify your account structure to accommodate your software, or change accounting software packages.

There are some cautions to consider in the design of your chart-of-accounts. The first is the trade-off between having greater detail and the difficulty of classifying your data. As your chart structure becomes more complicated, capturing your accounting data becomes more difficult and more prone to error. In our practice we often encounter our clients' desire to capture and report information in unlimited ways in opposition to our cautions to reign in the design to something more manageable. When designing your chart, consider whether you really do need that subprogram segment, or that department segment.

A second caution pertains to the difference between natural and functional account classifications when determining your General Ledger accounts. The general rule here is not to mix the two. Natural classifications are accounts like rent expense, postage, printing, and telephone. An example of a functional category would be fundraising costs that may include several natural accounts like salaries, printing and postage. Where possible, avoid using functional classifications among your general ledger accounts as these will make it more difficult for you to produce meaningful financial reports in different formats.

Using the guidelines presented above to set up your organization's chart-of-accounts will provide the necessary infrastructure to enable you to meet the diverse reporting needs of your organization.

[Features](#) >> [Behind the Numbers](#) >> [December 1-15, 2005](#)

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