Re-profiling the Accounting Cycle of Non-profit Organizations: An Organizational Ethnographic Research

Endang HARYANI*, **

Abstract

The purpose of this paper is to re-profile the accounting cycle model of non-profit organizations (NPOs). Child Development Centers (CDCs) in Indonesia have been selected as the multisite-operation NPOs for this research. The research is of a qualitative nature, and employs the organizational ethnography method. The results of the study show that the accounting cycle in NPOs consists of six steps. The first step is execution of the operation in the form of transactions based on the approved program/budget masters. The second step is recording the transaction documents in journals; followed by the third step, which is posting the entries into appropriate ledgers. The fourth step involves adjustment to the program/budget masters, when required. The fifth step is to prepare the financial reports, followed by the sixth and final step of formulating the forthcoming year's program/budget masters by referring to the reports. This study concludes that an accounting cycle in NPOs should follow a model that is different from those used in profit-oriented organizations and in NPOs that follow the accrual basis accounting model. The reason for this differentiated approach is that NPOs differ in nature, behavior, and business process. Moreover, adjustments in NPO accounting have different meaning, forms, and times of completion when compared with adjustments in general accounting.

1. Introduction

The accounting cycle plays a significant role in an accounting system since it ensures that organizations accomplish their goal of producing high-quality financial reports. In general, an accounting cycle contains sequential steps for handling and recording transactions before reporting. These steps should be standardized for all accounting officers. If the steps are not well understood, they cannot be standardized, and the organization's goal will not be achieved.

As an essential part of the accounting system, profit-oriented as well as non-profit organizations (NPOs) should clarify the details of the accounting cycle clearly. These details might differ since profit-oriented and NPO organizations have different goals. Profit-oriented

* Ph.D Student, Institute of Business and Accounting, Kwansei Gakuin University
** Lecturer, Satya Wacana Christian University, Indonesia

/commercial organizations operate to generate profits while NPOs achieve their mission and vision through programs, which may not necessarily generate profits. Most accounting literature has focused on the accounting systems of commercial organizations. Furthermore, most literature focuses on accounting cycles based on accrual accounting. Although many strands of the literature discuss the cycle for NPOs, accrual accounting continues to be the basis of application, and there is less focus on cash accounting cycles. However, in general, the same steps of the cycle are found in most literature, which are applicable for both types of organizations.

In Indonesia, non-profit organizations have been rapidly growing, mostly in the religious and advocacy sectors. According to the Ministry of Law and Human Right in NPO Domestic Review (2010, p. 33), 21,569 NPOs were officially registered, and had a legal status in 2009. Out of these, 21,301 NPOs, or 98%, had “Yayasan” (“Foundation” in English) as their legal status. The numbers of NPOs have been increasing, but the current benchmark of accounting cycle models are not quite relevant. The situation is becoming complicated for NPOs that have more than one office in different locations within Indonesia. NPOs, which have only one office, might not find it difficult to establish and maintain the cycle. However, multisite-operation NPOs, which have many offices, should be rigorous in managing their accounting cycles. Moreover, most accounting officers in NPOs do not have accounting knowledge. A reason for this is that job seekers do not perceive NPOs as the most favored career destinations. There is no doubt that potential employees will be more interested in commercial organizations than in NPOs. Hence, the accounting cycle should be standardized and chosen after considering that the employees in NPOs lack sufficient accounting knowledge. This will not only ensure consistency in maintaining transactions across all sites, but will also assure adherence to auditing and controlling requirements.

Therefore, this research has attempted to re-profile the accounting cycle model of NPOs. Child Development Centers (CDCs) in Indonesia, which conduct activities in community development with a focus on education are the selected multisite-operation NPOs in this research. To produce their financial reports, CDCs follow the cash accounting model. These financial reports are forms of accountability to stakeholders such as Compassion International, Compassion Indonesia Foundation (CIF), child sponsors, and partner churches. Therefore, the financial reports should ideally be maintained by a person with an accounting background. However, merely having an accounting background may not be enough. The person in charge of accounts should be guided by an appropriate accounting cycle. Hence, the model will be a generic one, developed from the accounting cycle in CDCs. The model has the following objectives: (1). to standardize the accounting cycle for CDCs; (2) to provide NPOs, in general, a benchmark model to use; and (3). to contribute to the accounting system of literature for NPOs.

2. Literature Review

Accounting cycle

An accounting cycle can be defined as "*the accounting process that begins with analyzing and journalizing transactions and ends with the post-closing trial balance*" (Warren, Reeve, Duchac, 2014, p. 162). Based on an accrual accounting basis, Bastian (2007, p. 96) has explained that an accounting cycle for NPOs consists of several chronological components, which document transactions, journals, ledgers, trial balance, financial statements, closing, and reverse as an optional step. Organizations perform the steps in the cycle in a sequence and repeat them in each accounting period (Kimmel, Weygandt, Kieso, 2013, p. 161). According to the above definitions, the general accounting cycle has been drawn in Figure 1.

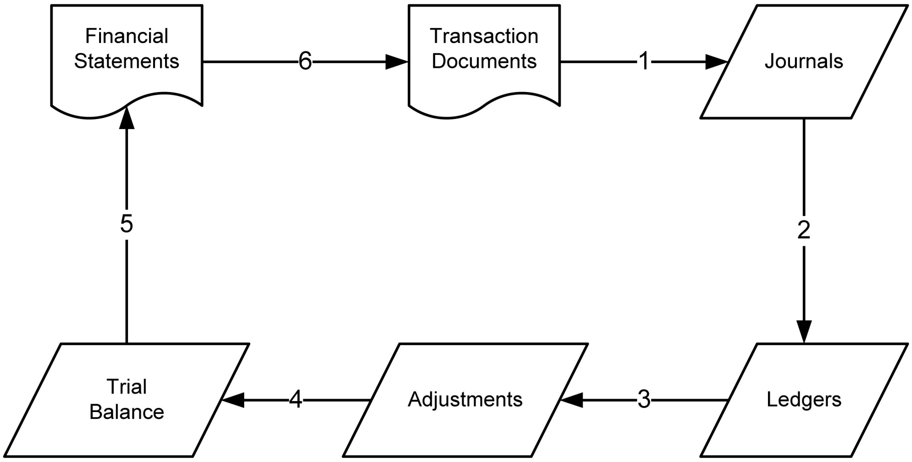

Figure 1. General Accounting Cycle

Cash and Accrual Basis of Accounting

The cash basis of accounting can be defined as "*the method of recording transactions by which revenues and expenses are reported in the period in which the related cash receipts or disbursements occur*" (The Canadian Institute of Chartered Accountants, 1981, p.50). The accrual basis is "*the method of recording transactions by which revenues are reported in the period in which they are considered to have been earned or restrictions satisfied, and expenses are reported when incurred, whether or not the transactions have been finally settled by the receipt or payment of cash or its equivalent*" (The Canadian Institute of Chartered Accountants, 1981, p.50).

Child Development Centers

A CDC is a primary form of partnership between CIF and the partner church. Therefore, the CDC is an element of the church, which is one of the executor parties in providing support to needy children. Through the CDC, the partner church identifies and nourishes needy children. The CDC serves children of various age groups, from as early as three years to as late as 22 years (Yayasan Compassion Indonesia, 2007, p. 10). Partner development is the goal of the Foundation's work. CIF aims to increase the capacity of partner churches to become more efficient in performing child development programs holistically. The comprehensive programs consist of four aspects – cognitive, socio-emotional, spiritual, and physical.

Previous research

Many books have discussed the accounting cycle as a part of the financial accounting subject. Most books talk about the accounting cycles in business enterprises, which apply the accrual basis accounting model. However, there is no research on the accounting cycle, especially for NPOs. This research, therefore, is supposed to become a new reference in the accounting cycle for NPOs, especially in Indonesia, which use cash basis accounting.

Based on Pernyataan Standar Akuntansi Keuangan 45 ("Financial Accounting Standard Statement" in English) (Ikatan Akuntan Indonesia, 2011, p.45.4), financial statements, which are the main output of the accounting cycle of NPOs, have the same components as commercial organizations. According to Bastian (2007, p.86), based on the accrual model, the accounting cycle for NPOs has the same stages as profit-oriented organizations. These facts indicate that NPOs have no different profile of accounting from profit-oriented organizations. Gross (Gordon and Kumawala, 2009, p. 251) has argued that the accounting profession should determine the accounting profile for NPOs. While Fetterman (Gordon and Kumawala, 2009, p. 251) has disputed that NPOs have no accounting profile.

Haryani and Pranoto (2014, p. 231) researched about accounting systems for CDCs. They proposed a transactions cycle framework as shown in Figure 2. The accounting cycle is a part of the general ledger and reporting system. Consequently, this study is an extended research of the developed framework.

3. Research Methodology

This study is a qualitative research that uses a combination of research and development approach. The work has employed the organizational ethnography method. It involves the observation of, and participation in, particular groupings (Neyland, 2008, p.1), and consists of primary and secondary data. The primary data is the result of participation in, and observation of, the ethnography process. The secondary data is the result of a documentation

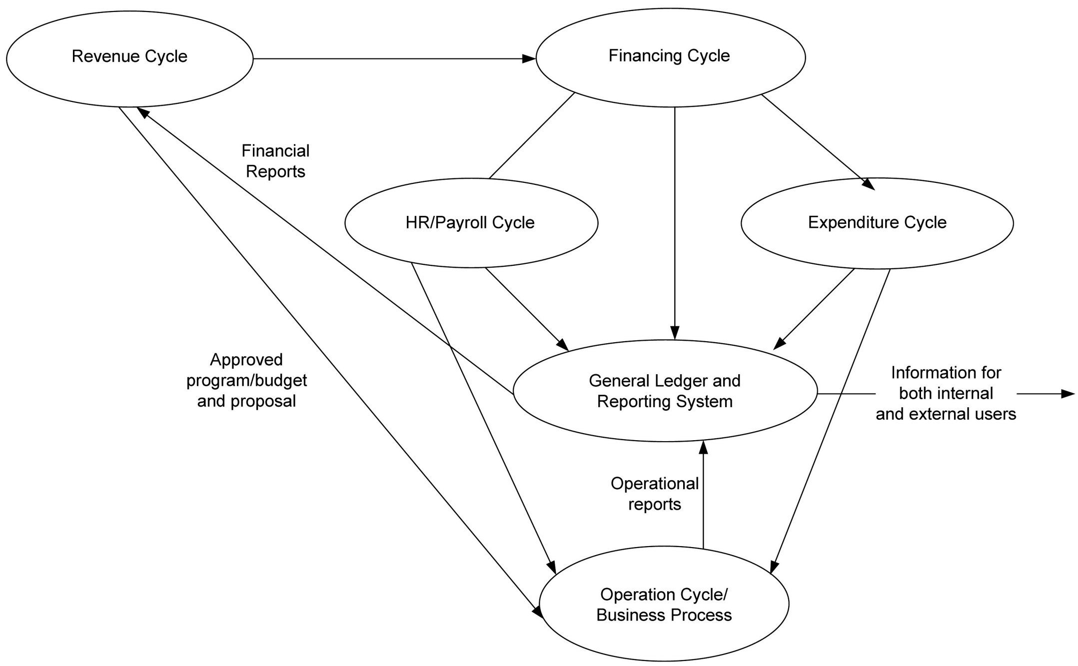

Figure 2. Transaction Cycles (modified) (Haryani and Pranoto, 2014)

study such as financial reports of CDCs. A generic accounting cycle model has been derived from the ethnography process. The model has been confirmed with the CDCs through a focus group discussion.

The main argument for selecting this research methodology is that it can disclose an NPO's viewpoints toward the accounting cycles. It is supposed to preclude manipulation of information since people tend to conceal their weaknesses and embellish their strengths. Most people in NPOs do not comprehend the terminologies in the accounting context, but they are able to understand their usage.

As a participant observer, the researcher relied on participation and observation to reply to questions pertaining to the operations of NPOs. The research was conducted from February 12 to February 25, 2015 during working hours (08.00 – 17.00 Western Indonesia Time) in 15 CDCs. The observations were gathered through usual office interactions, followed by their daily conversation about processes and issues in bookkeeping. The accounting process in CDCs also involves an internal auditor, a treasurer, a secretary, and a mentor. The observations were also gathered by analyzing the archives of NPOs, especially financial reports and meeting notes.

4. Result and Discussion

Current Accounting Cycle

CDCs apply cash basis accounting in their financial reporting system. The fiscal period of financial reports in CDCs is from July 1, year Y1 to June 30, year Y2. Before July 1, the CIF approves the program / budget masters. Based on the approved masters, CDCs start their accounting cycle.

The first step in the cycle is related to running programs based on the program/budget masters. The master is an annual plan (both activity plan and budget), which is spread out on a monthly basis for a fiscal period from July 1, year Y1 to June 30, year Y2. The administrative staff prepares the masters. Before the commencement of the fiscal period, the CIF analyzes and approves the masters after verifying whether the CDCs have met the Foundation's requirements. The masters comprise programs and their budgets, which are, in fact, detailed presentations of each account. The programs are divided into routine and non-routine categories. The routine programs refer to child mentoring, which are held on a weekly basis. Non-routine programs are non-mentoring activities, which are annual events, such as Christmas celebrations, field or togetherness activities.

The CIF plays a fundamental role of approving the program / budget master and program proposal. Without the approval, a CDC cannot run its programs. The CIF transfers supporting funds every month from child sponsors to CDCs and receives monthly financial reports from them. For operational ease, the CIF is supported by some entities such as Partner Facilitators (PF), Child Sponsors (CS), and auditors. The PF is a person appointed by the CIF to help out and control a group of CDCs (called a cluster). The CS is a fund provider for each child, and transfers the contribution to CDCs through CIF. The CS receives letters addressed to the children and helps draft replies to those letters as well. An auditor is an independent person who assesses a CDC from a holistic aspect – from program execution and financial accountability.

The CDC's staff executes the programs according to the approved masters. Each program has a detailed plan and budget. The programs are funded by monthly support funds, and are the CDC's revenue. When the budget is used to finance the programs, it results in transactions. In order to run the programs, executors need third parties who provide goods and services. Procurement transactions involve the exchange of goods and services. The transactions should be proven by relevant documents.

The CDC's staff is composed of operational and administrative personnel. The operational staff is obligated to mentor the children. The administrative staff is office personnel, including the coordinator, secretary, and treasurer. Mentors are the prime executors of routine programs and prepare mentoring documents, such as lesson plans, performance evaluation of children and classes, visit reports, attendance monitoring, and documents of children. A treasurer manages cash collection and disbursement. A secretary handles the administration of children and office, and has an accounting function to prepare financial reports. Mentors and administrative staff are executors of non-routine programs, and deal with operational reports as per the program. All staff personnel receive monthly special offerings as their rewards, calculated and prepared by committees.

All programs are dedicated to children registered by the CDC. They comprise sponsored and unsponsored children. Sponsored children are those selected by CS. Children in this group receive support and gifts. They get CS' letters and have to reply to their sponsor. Unsponsored children do not have CS. They receive only support. Photographs of such children are posted on Compassion International's website until they get CS. These two groups of children have to participate in both routine and non-routine programs.

As the next step, the treasurer records transaction documents in the log book of cash in hand and in the bank. This log book acts as a journal worksheet (Appendix 1). It demonstrates that CDCs have two kinds of cash – "cash in hand" and "cash in bank." "Cash in bank" is represented by a bank account book. While "cash in hand" is recorded in special journal entries, cash receipts, and cash payments. The treasurer records the transactions in the log book for every contribution received and disburses it according to the date of transactions. There is a possibility of "cash-in-advance," but it will not be recorded in the log book as it has not been used in any transactions, and does not have evidence.

In the next stage of the accounting cycle, the secretary posts each entry into an appropriate ledger according to the account number and reference number (Appendix 2). During the month, the secretary and the treasurer actively verify the difference amount in the monthly budget and the current disbursement for each account and program. Then, they notify the coordinator whether programs have been delayed or not, and if budgets have been fully absorbed as planned or not. If they have not, the administrative staff should ask about the issues to executors who can be mentors as well, or the person who is in charge of the programs. Based on the reasons, the coordinator urges executors to prepare adjustments in the form of program proposals, either to change the budgets or rearrange the programs. The proposals need approval from CIF before implementation.

Failure to manage these adjustments has significant consequences on CDCs. It not only creates a high-balance budget at the end of the month, but also affects the continuity of future support. The high-balance budget condition signifies to the CIF that CDCs have failed to accomplish the program. This results in CDCs not receiving subsequent monthly support from the CIF. In the end, it means that children face an adverse situation.

After finishing ledgers and managing adjustments, the CDC staff prepares the reports, which consist of the main financial reports (Appendix 3), the cash reports (Appendix 4), and the supplementary documents such as operational reports. An operational report comprises an activity profile, a simple contribution-disbursement report, and an activity evaluation. The financial reports compare the actual disbursements and budgets for each account. It results in accumulations and differences. Along with the operational reports that show the performance of every program, the financial reports are analyzed to prepare the budget for the next fiscal year.

At the end of the month on the book-closing date, the CDC's secretary has to complete the financial reports. The reports are sent to the committee members of partner churches. The committee functions as an internal auditor, who handles the internal audit process. During the auditing process, an internal auditor may carry out verification and confirmation, or inquire if a correction is needed. The result of this process is the audited financial reports. The secretary has to submit them to the CIF by no later than the sixth day of the subsequent month. For example, the audited financial report of September 2014 has to be submitted by no later than October 6, 2014.

Figure 3 summarizes the existing accounting cycle followed by CDCs as explained above.

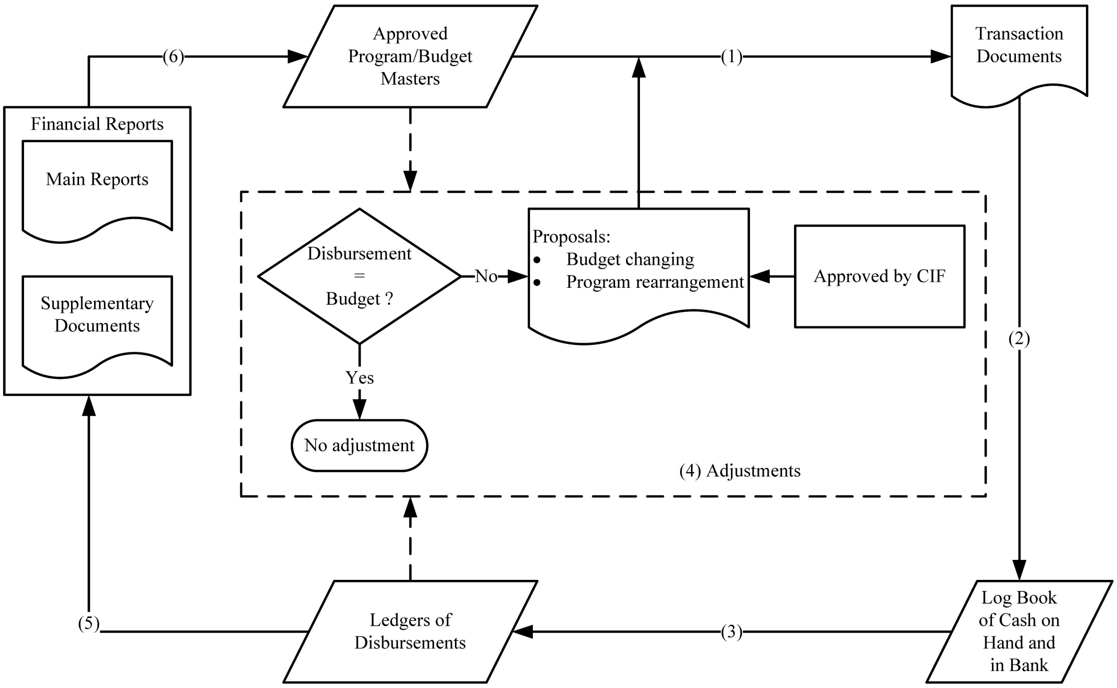

Figure 3. Accounting Cycle in CDCs (Processed data)

Proposed Accounting Cycle Model

Based on the current accounting cycle described above, it has been explained that in the cash accounting model, transactions are recorded at the time of either receiving contributions or executing disbursements. There are no unpaid bills or uncollected income at the end of a period. However, the financial reports should be complete in terms of execution of all the programs and absorption of the budget in a particular month. When a running program is delayed, or fails, it creates a high balance in the budget. It not only indicates that the budget has not been fully absorbed by the CDC, but also leads to cancellation of support for the following month. Budgeting plays a significant role in an NPO's operations, and shows up on its performance.

Transactions in NPOs are based on the budgets; consequently, the execution of programs should be based on the program/budget masters. Transactions are associated with disbursements. In spite of using the terminology of expenses, disbursements are more germane in NPOs, since NPOs do not spend money to earn revenue. In addition, contributions are more relevant for NPOs as they do not operate to generate revenue.

Adjustments in NPOs should have a very different meaning. In accrual basis accounting, if there are unpaid bills and uncollected income, adjustments are applied to recognize revenue and expense for an appropriate period of reporting. However, in cash basis accounting, NPOs adjust the difference amount of the actual disbursement and the budget of the current month. In other words, adjustments have illustrated that the running of the program and budget is not congruent to their plans. It will lead to over- or under-budgeting. In either case, executors have to get proposals ready to amend the difference. Furthermore, forms of adjustments are not journal entries, but additional or alternate programs/budgets. If the accrual basis is applied, the adjustments are completed at the end of the month. In the case of cash basis accounting, the adjustments may be administered in the current period.

Financial reports do not denote the end of the steps. Along with the budget, financial reports are the primary output of the accounting cycle. The reports are then collectively analyzed. The reports describe the achievement of the planned programs and the budget absorption. The more the number of planned programs the NPO is able to accomplish, the more successful it is considered. The lesser the difference between the financial reports and budgets, the more successful the NPO is.

Regarding the cash basis accounting and budget-based transactions, there are two proposed definitions of an accounting cycle and an adjustment. An accounting cycle can be defined as "*the accounting process that begins with executing planned programs / budget and journalizing the transactions and ends with producing the financial reports and setting the next year's planned programs / budget.*" While an adjustment is "*an analyzing process to adjust the difference amount of the current period budget and the actual disbursement, so*

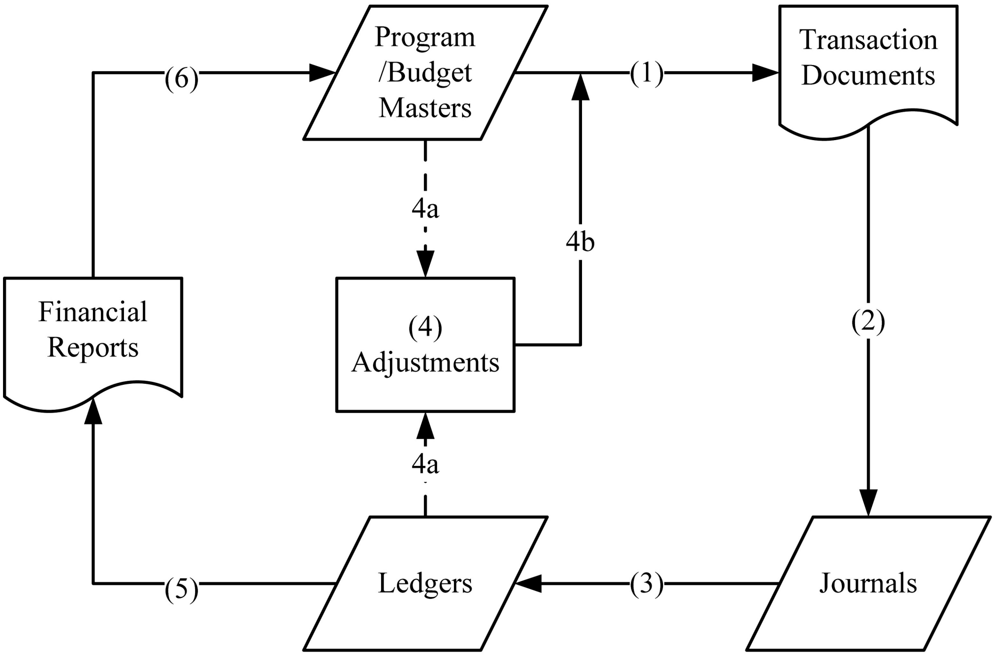

Figure 4. Proposed Accounting Cycle Model (Processed Data)

that the budget will be fully absorbed during the current period."

5. Conclusions and Recommendations

Based on the result and discussion, a generic model of accounting cycle has been developed. It is a novel model for NPOs, and it may become a new benchmark for CDCs and, especially, for other NPOs that use cash-basis accounting.

The model consists of six steps. The first step is execution of the operation in the form of transactions based on the approved program / budget masters. The second step is recording the transaction documents in journals, followed by the third step that is posting the entries into appropriate ledgers. The fourth step involves adjustment to the program / budget masters, when required. The fifth step is to prepare the financial reports, followed by the sixth and final step of formulating the forthcoming year's program / budget masters by referring to the reports.

This study has concluded that an accounting cycle model of NPOs should be different from that of commercial organizations and NPOs that use accrual basis accounting. The reason for this differentiated approach is that NPOs differ in nature, behavior, and business process. Moreover, adjustments in NPO accounting have different meaning, forms, and times of completion when compared with adjustments in general accounting.

Future research should include developing a performance measurement model for NPOs based on financial reports and budgets. Besides, the detailed bookkeeping components in the accounting cycle should be analyzed deeply, such as determining the effectiveness of journal worksheets and ledgers.

Notes

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Appendix

Appendix 1. Log Book of Cash on Hand and in Bank

Log Book of Cash on Hand and in Bank (in Indonesia Rupiah)

Page: 1/…

Number	Date		Details	Number of Accounts	Cash on Hand			Cash in Bank		
					Debit	Credit	Balance	Debit	Credit	Balance
	Sept 2014		Opening balance		1,672,162		1,672,162	47,192,848		47,192,848
1		1	Photocopying – coloring class, age 3-5 years	11		4,400	1,667,762			47,192,848
2		2	Withdrawal	#	6,100,000		7,767,762		6,100,000	41,092,848
…										
89		16	Support, September 2014	R-60				39,350,298		67,643,146
90		16	Gifts, September 2014	R-70				1,862,062		69,505,208
…										
117		22	Local contribution of the church, September 2014	R-60	750,000		15,860,162			56,605,208
…										
180		30	Interest	R-60			6,027,821	40,792		43,946,000
181		30	Tax	59			6,027,821		8,158	43,937,842
…										
Balance					47,254,662	41,226,841	6,027,821	88,937,312	44,508,158	44,429,154

Source: Secondary data (translated), IO847 - Agape, September 2014

Appendix 2. Ledger

Ledger (in Indonesia Rupiah)

Name of account : Cognitive development expense

Account number : E-10

Number	Date		Details	Ref	Debit	Credit	Balance
	Sept 2014		Opening balance				
1		2	Funding for supporting book, Elementary school - Nadila Octaviana (0699)	3	30,000		30,000
...							
52		26	Tuition fee September 2014, group of ages 3 – 18 years old	168	2,563,000		4,597,500
Balance					4,597,000		4,597,000

Prepared by:	Approved by:	
Treasurer	Coordinator	Committee
Ratna Triastuti N	Lina Kusuma Dewi	Nanik Rahastuti
29/09/2014	30/09/2014	02/10/2014

Source: Secondary data (translated), IO847 - Agape, September 2014

Appendix 3. Financial Report

Financial Report (in Rupiah)							
CDC profile/information							
Accounts		Expense of the month	Budget of the month	Differences (+/-)	Expense accumulation until this month	Budget accumulation until this month	Accumulation differences (+/-)
Cognitive	E-10 Cognitive development expense …						
Physical	…						
Spiritual	…						
Socio-emotional	…						
Administrative	…						
E-60.1	Support expenses	38,339,958					
E-60.2	Internal transfer	249,100					
E-60	Total of support expenses	38,589,058					
E-70	Total of gifts expenses	1,861,941					
E-80	Total of special/additional support expenses	784,000					
Total Expenses		41,234,999					

Source: Secondary data (translated), IO847 - Agape, September 2014

Appendix 4. Cash Report

Cash Report (in Rupiah)					
Detail	Beginning Balance (A)	Revenue (B)	Total (C=A+B)	Expense (D)	Ending Balance (E=C-D)
60 Support	48,078,307	40,964,902	89,043,209	38,589,058	50,454,151
70 Gifts	2,750	1,862,062	1,864,812	1,861.941	2,871
80 Special/additional support	784,000	-	784,000	784,000	0
Total	48,865,057	42,826,964	91,692,021	41,234,999	50,457,022

Cash Detail	
Cash on Hand	6,027,800
Cash in Bank	44,429,154
Total	50,456,954
Closing date	30 Sept 2014

Source: Secondary data (translated), IO847 - Agape, September 2014