WOULD YOU DRIVE BLINDFOLDED? –-*WHY YOU NEED CONTROLLERSHIP*

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Introduction

No one would ever drive blindfolded. However, your organization's internal financial statements may be leading you to do just that. It's a challenge to staff all the finance functions an organization needs on a limited budget. Organizations may inadvertently squeeze out the important controllership function, leaving management and the Board with misleading internal financial statements. Below we will explore some examples that illustrate why controllership matters and discuss some solutions for ensuring that you are leading your organization with timely and accurate financial information.

The challenge

In smaller associations and charities, especially those with a limited budget and staff size, a few individuals wear many hats. One accountant is called upon to serve as both bookkeeper and controller and the CEO usually takes on the budgeting and reporting duties of a CFO. When this happens, the important middle layer of the accounting function can get squeezed out—with unfortunate results. Board members can be looking at financial statements with positive net income all year, only to see big adjustments when year-end reconciliations are done.

Accounting is like a layer cake

To understand why this happens, it helps to understand the three layers of accounting; operational, controllership and strategic. In large organizations, these functions are performed by different individuals with different skills and compensation levels. The finance office is staffed with full-time accountants at each functional layer, like a layer cake. Smaller organizations can't afford to pay for the whole cake, so they often opt for just buying one layer—basic accounting.

Operational accounting--recording transactions

Experienced operational accountants, or bookkeepers, accurately conduct and record basic transactions, paying the bills, depositing collections and handling payroll. There are basic systems for these types of transactions; accounts payable, accounts receivable and payroll. The systems record the transactions on the books as they are conducted, resulting in basic financial data. At this point, the financial statements can be printed out, but they really only consist of raw data.

Controllership—making sure recorded balances are right

The mid level of accounting is controllership. The controller looks at the raw accounting data that resulted from the system transactions, like paying bills, depositing income and paying payroll. The controller uses personal initiative, skills and specialized accounting knowledge to review the accounts to see if they are accurate, and to see if they are recorded on the accrual basis in accordance with generally accepted accounting principles. Most bookkeepers also do basic controllership such as performing bank reconciliations and making adjustments as needed.

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Just what are reconciliations and adjustments?

The controller reviews recorded account balances for accuracy at month-end by preparing schedules, or workpapers, that support the accuracy of the material balance sheet accounts, and selected income and expense accounts. Sometimes, recorded balances are compared to outside data such as a bank statement or line of credit balance. This process of determining what the recorded ending balances should be is referred to as "reconciliation". Sometimes the controller finds that transactions need to be reclassified or that accruals or deferrals need to be recorded into, or reversed out of, the current period. In that case, the controller makes an "adjustment" to the books. Without these month-end reconciliations and adjustments, the Board could be looking at financial statements that are misleading.

Strategic accounting—using accounting data

At the top level of the finance function, the CFO, or CEO in smaller organizations, reviews actual amounts compared to budget, presents financial statements to the Board, recommends appropriate courses of action, and prepares next year's budget. For the accounting function to provide accurate financial information for management decisions and Board oversight and governance, the financial information must be reasonably accurate. Without the controllership level making sure the financial statements are right, management and Board members can be steering the organization while blindfolded.

How bad could it be?

Here are some scenarios that can happen when the Board makes decisions based on raw financial data:

> **Unexpected expenses.** All year, an association's statement of activities showed positive net income of $20,000. This seemed to be a result of a profitable special event early in the year. At year-end, it was discovered that a large hotel deposit made in the prior year for the special event, was still sitting on the balance sheet in prepaid expenses, and was never adjusted into special event expenses of the current year. Once the $30,000 prepaid expense was adjusted to the current year, the association's supposed net income turned into a net loss of $10,000. Because the prepaid account was not reviewed and adjusted during the year, management and the Board were steering the association while blindfolded.
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> **Disappearing income.** All year, a charity's statement of activities showed positive net income of $20,000. This seemed to be a result of good collections from corporate sponsors early in the year. At year-end, it was discovered that three large corporate sponsor contributions had been recorded as receivables at the end of the prior year, and were still sitting on the balance sheet as accounts receivable. When the sponsor money was collected in the current year, it was counted as income instead of relieving the receivables—effectively double counting the income. Once the $30,000 of collections was taken out of current year income and applied against accounts receivable, the association's supposed net income turned into a net loss of $10,000. Because the accounts receivable account was not reviewed for accuracy during the year, management and the Board were steering the charity while blindfolded.

Floating income. At year end, an organization's statement of activities showed positive net income of $200,000. This seemed to be a result of an increase in grant activity late in the year. At year end, it was discovered that three large grant receipts were recorded as grant income when they were actually unspent advances of grant money to be used next year to pay allowable costs. When the $300,000 of grant advances were taken out of current year grant income and recorded as deferred income, the organization's supposed net income turned into a net loss of $100,000. Because the deferred income account and the recorded grant income and expenses were not reviewed for accuracy during the year and adjusted properly, management and the Board were steering the organization while blindfolded.

What to do?

Nonprofit Execs and Board members should take steps to educate their fellow organization leaders about the nature and importance of controllership. It's difficult to convince Board members that controllership is needed unless you can explain clearly what it is and what it does. The above scenarios can serve to illustrate that inadvertently skipping timely controllership has the unintended consequence of steering the organization while blindfolded.

Fortunately, organizations do not have to hire a separate full time employee for each layer of the accounting cake. Part-time and outsourced controllership is available to make sure the organization's books are reconciled and adjusted on a timely basis. By engaging part-time help for the controllership function, the nonprofit effectively buys a slice of each layer of the cake in just the amount needed.

Conclusion

No one would drive blindfolded. However, nonprofit Execs and Board members who make decisions based on raw financial data may be doing just that. Without the important controllership function, internal financial statements can be misleading. Fortunately, organizations can outsource controllership and get just the amount of services needed. This will allow smart nonprofit leaders to take off their blindfolds and steer the organization with timely and accurate financial information.