



# If You Can't Use "Funds," Can You Still Use "Fund Accounting"?

*Nonprofits are grappling with drastic changes in their accounting methods. What do these changes mean for you?*

Q:

I've heard that new rules require nonprofit organizations to revise the way they account for contributions and present their financial statements. As I understand it, one of these changes is that the word "fund" is no longer used in nonprofit financial statements.

Does this mean that nonprofits no longer need to use "fund accounting"? Do we still need to track individual funding sources in our books, or should we commingle them? Should we continue using fund accounting software? I'm confused! Please help.

A: You aren't the only one confused by the new rules. Many nonprofits are asking similar questions about the changes, which are explained in Statement of Financial Accounting Standards (SFAS) Numbers 116 and 117. These rules affect nonprofits' financial statements for fiscal years beginning after December 15, 1994, except for organizations with less than \$5 million in total assets and less than \$1 million in annual expenses. For those smaller nonprofits, the rules affect financial statements for fiscal years beginning after December 15, 1995.

First, let's discuss what fund accounting is. Then we'll answer your questions about whether you can still use fund accounting—and the extra demands that SFAS 116 and 117 put on your accounting system.

## What Is Fund Accounting?

The need for nonprofits to be more accountable to their donors led to the accounting style called "fund accounting" to differentiate it from commercial

accounting methods. In fund accounting, you allocate money into separate balancing sets of books and handle them according to donor restrictions. In fund

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**With the extra demands of SFAS 116 and 117, a good fund accounting system is more imperative than ever.**

accounting, you also produce financial statements and reports by fund, or by grouping funds together. Many nonprofits use funds to segregate money according to its source, so that their "funds" are essentially the same as "funding sources."

Besides detailed tracking, fund accounting software provides the

reporting flexibility needed to present information to many internal and external requesters in a variety of formats. Fund accounting software also lets you allocate expenses easily across funds or fund groupings. (See the list of fund accounting functionality on page 9).

## How Do SFAS 116 & 117 Affect Nonprofit Accounting?

When the Financial Accounting Standards Board (FASB) introduced SFAS 116 and 117, it was the first time FASB issued statements about how nonprofit organizations should account for contributions and how they should present these contributions in their financial statements. SFAS 116 defines how nonprofits should report donations, including pledges, donations of services, works of art, and so on. SFAS 117 further clarifies how nonprofits should report contribution information in their financial statements.

The intent of SFAS 116 and 117 is to enhance the relevance, understandability, and comparability of nonprofits' financial statements. These reports are primarily used by donors, members, creditors, and others who provide resources to nonprofits. By having standardized financial statements, these resource providers can make better assessments about how well a nonprofit is performing.

You're right to point out that the word "fund" is no longer used in nonprofit financial statements. That's because the focus of SFAS 117 financial statement reporting is now on "net asset" classification, rather than on traditional "funds." The new net asset



classes combine contributions according to donor-imposed restrictions. Thus, there are three net asset classes: unrestricted, temporarily restricted, and permanently restricted.

Other significant SFAS 116 and 117 changes are as follows:

- You must now provide three financial statements:
  1. Statement of Financial Position (new name for Balance Sheet).
  2. Statement of Activities (essentially a combined Statement of Revenues and Expenditures by function, with a few differences). This statement does not preclude providing disaggregated information by fund groups.
  3. Statement of Cash Flows.

expenses for programs, fundraising, and so on. (In addition, voluntary health and welfare organizations must provide a separate statement which details expenses, in a grid, showing natural classification by function. A separate statement of functional expenses by natural classification is optional, but encouraged, for all nonprofits.)

### Do You Still Need to Track and Report Using Funds?

SFAS 117 does not prevent nonprofits from issuing financial statements in whatever format they need. This means it's fine for you to continue using funds if it helps your contributors track how their money is being spent, or if it helps your departments track whose money is being applied to programs and how much of it remains.

SFAS 117 does not mandate the way you create other kinds of reports or budgets (though there is an optional SFAS 117 budget format available). Nor does it dictate the specific reports that funding sources or donors may require. Funding sources and donors can ask for SFAS 117-compliant statements and/or financial statements formatted by fund as well as their own unique report formats. Most nonprofits will also need to comply with SFAS 117 to receive a "clean" opinion from their auditor.

So, SFAS 117 does *not* eliminate the reason for nonprofits to track and report by fund. You will likely need to track funds internally to ensure that monies received from a variety of sources are not commingled, while, for external purposes, you need the net asset classifica-

## WHAT'S THE DIFFERENCE BETWEEN COMMERCIAL & FUND ACCOUNTING SYSTEMS?

Commercial companies have accounting systems that measure performance primarily by profit and loss. Since nonprofits have different purposes, goals, and accountability from for-profits, their accounting systems must reflect those differences. For example, nonprofits' accounting systems must do the following:


1. Keep a formal budget as part of the organization's books. (It may also be a legal document.)
2. Track and report accounting records separately for different funding sources, grants, departments, programs, and/or functions (and be able to allocate expenses across these groupings).
3. Track and report across different time periods (frequently not an annual basis), which often span multiple fiscal years.
4. Keep funds separately, according to donor restrictions.
5. Measure the success of programs and fundraising events.
6. Track the ratio of overhead to program usage.
7. Track encumbrances.
8. Produce specialized reports for different internal and external audiences, including the Financial or Governmental Accounting Standards Boards (FASB and GASB).

Once nonprofits reach a certain size and have more than one funding source, they find that commercial accounting software will not meet these special tracking and reporting requirements. That's why fund accounting software was invented.

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- You must record pledges (now called "promises to give"), in total, when the donor makes the pledge.
- You must record the entire amount of a multiple-year contribution or pledge in the year you first received it.
- Barring specific donor or legal restrictions, you must report income from permanently restricted assets (that is, endowments) as unrestricted income, separately from permanently restricted assets.
- You must show expenses by function in total—for example, total



tions required by SFAS 117. Tracking by fund will let you create internal reports on how much of a particular funding source remains unspent versus a budgeted amount. It will also let you see how much money a particular program used from a variety of funding sources. Alternatively, if you don't need to track funds for internal or external purposes, you don't have to use fund classifications.

### If You Don't Track Funds, Do You Still Need Fund Accounting Software?

Since tracking and reporting by funds are only a small part of nonprofit accounting requirements, and SFAS 117 focuses only on the financial statements of nonprofits, there are many other things to keep in mind. For example, see the list of eight things a nonprofit accounting system must be able to do (page 9). Fund accounting software helps nonprofits meet these eight accounting needs in ways that commercial accounting software cannot.

Even if you don't have to track funds, you'll find it difficult to perform these eight tasks without software designed for nonprofits. Nonprofits find that trying to use commercial accounting systems to perform these unique nonprofit accounting functions is impractical, difficult, and expensive.

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accounting system designed for your needs. Nonprofits often use spreadsheets to try to compensate for commercial software's missing functionality. However, spreadsheets are time-consuming, introduce inaccuracies, and are more confusing than enlightening for nonprofits. Custom modifications or overlays to commercial software pose high up-front costs and are very expensive to maintain year after year. Thus, like most nonprofits, you will probably find that the only efficient way to fulfill your accounting requirements is with fund accounting software, because it is developed specifically for your unique tracking and reporting needs.

### What's the Final Answer?

To answer your questions, then:

- Yes, the new rules drastically change the way you need to prepare your financial statements.

- Yes, one of the changes is that your financial statements will no longer contain the word "fund."
- No, this doesn't mean that you should give up fund accounting or fund accounting software. Rather, with SFAS 116 and 117 you have *additional* requirements. You will probably still want to track individual funding sources in your books rather than commingle them. Even if you don't, you'll find fund accounting software helpful for all your unique accounting needs. With the extra demands of SFAS 116 and 117, a good fund accounting system is more imperative than ever.

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*Also see the article "Are You Ready for the New Accounting Rules?" in Nonprofit World, January-February 1994, and the informative free booklet, "A Guide to Purchasing Accounting Software for Nonprofit Organizations and Governmental Agencies" distributed by Micro Information Products (see above address, phone, and fax numbers). MIP has designed Windows and DOS fund accounting software for nonprofits' unique needs since 1982 and has over 3,300 customers worldwide.*