The Impact of SFAS 116 & 117 on Nonprofit Organizations

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The Statement of Financial Accounting Standards (SFAS) Numbers 116 & 117 relate how non-governmental nonprofits account for contributions, and how they present their financial statements. These pronouncements have created much confusion among nonprofits with regard to their accounting methods. Since the word "fund" is no longer used in financial statements, do nonprofits still need "fund accounting?" Since SFAS No. 117 relates to the presentation of financial statements, does it impact day-to-day record keeping? Do nonprofits still need to track individual funding sources separately in their books anymore, or should they be commingled? First, let's understand what Fund Accounting is, then we'll look at the impact of SFAS 116 & 117 on accounting for nonprofits.

Fund Accounting

The need for greater accountability to funding sources and donors gave rise to the traditional style of nonprofit accounting called "fund accounting," which has been used by nonprofits for many years. A fund is "an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves, and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulation, restrictions, or limitations." In other words, in fund accounting you allocate money into separate funds and produce financial statements and reports by fund, or by grouping funds together. Many nonprofits use funds to segregate their monies according to its source, so that their funds are essentially the same as funding source. In addition to detailed levels of tracking, Fund Accounting software provides the reporting flexibility required to present information to many requesters, both internal and external to nonprofits.

SFAS 116 & 117

When the Financial Accounting Standards Board (FASB) introduced SFAS Numbers 116 & 117, it was the first time FASB issued statements regarding how nonprofit organizations should account for contributions and how these contributions are presented in financial statements. Specifically, SFAS 116 defines how donations are accounted for by donors and receivers, according to donor-imposed restrictions. SFAS 117 further clarified generally accepted accounting principles with regard to how nonprofits report contribution information in financial statements. It affects 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. Those organizations must begin to use SFAS 117 for fiscal years beginning after December 15, 1995.

The intent of SFAS 116 & 117 was 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 concerning how well a nonprofit can continue to provide services, as well as
how the nonprofits performed, and how well their management discharged their stewardship.

The focus of SFAS 117 financial statement reporting is now on "net asset" classification, rather than on traditional funds or groups of funding sources. The new net asset classes aggregate contributions with like donor-imposed restrictions, and are: unrestricted, temporarily restricted, and permanently restricted. Other significant SFAS 116 & 117 changes are:

- There are now three required financial statements:
  - Statement of Financial Position (new name for Balance Sheet)
  - Statement of Activities (essentially a combined Statement of Revenues and Expenditures by function). This statement does not preclude providing disaggregated information by fund groups.
  - Statement of Cash Flows
- Promises to give (pledges) are recorded, in total, when the promise is made
- The entire amount of a multiple-year contribution or pledge is recorded in the initial year it is awarded to the organization
- Baring specific donor or legal restrictions, income from permanently restricted assets; i.e., endowments, are reported as unrestricted income separately from the permanently restricted assets
- Certain recording restrictions apply to the recording of contributed services
- All organizations must show expenses by function in total (e.g., totals for programs, fund raising etc.). In addition, voluntary health and welfare organizations must provide a separate statement that details expenses, in a grid, showing natural classification by function. A separate statement of functional expenses by natural classification is optional, but encouraged, for non voluntary health and welfare organizations

Do I still need to track and report using funds?
SFAS 117 does not preclude or prevent nonprofits from issuing financial statements in whatever format they need, in order to serve a purpose. This means it's fine to continue using fund classifications if it helps a contributor 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 did not mandate the way nonprofits can create many other kinds of reports, nor did it mandate the format of budgets (though there is an optional SFAS 117 format available). It also did not dictate the specific reports that funding sources or donors may require--funding sources and donors can ask for either SFAS 117-compliant statements, or financial statements formatted by fund, as well as their own unique report formats. However, most nonprofits will probably need to comply with SFAS 117 in order to receive a "clean" opinion from their auditor.

So, SFAS 117 did not eliminate the reason for nonprofits to track and report by fund. Nonprofits will likely need to internally track funds to ensure that monies received from a variety of sources are not commingled, while, for external purposes, they need the net asset classifications required by SFAS 117. Tracking by fund enables nonprofits to create internal reports on how much of a particular funding source remains unspent versus a budgeted amount, or how much of a variety of funding sources were spent by a particular program or department. Alternatively, if you don't need to maintain funds for internal purposes, you don't have to have funds.

If I don't need funds, do I still need fund accounting software?
Since tracking and reporting by funds are only a small part of nonprofit accounting, and SFAS 117 focuses only on the financial statements of nonprofits, there are many other considerations to keep in mind. For example, see the list of accounting functionality nonprofits need that was mentioned in the earlier section "What's the Difference Between Commercial & Nonprofit Accounting Systems?" You can also refer to the informative free booklet, "A Guide to Purchasing Accounting Software for Nonprofit Organizations and Governmental Agencies" distributed by MIP. Even if you don't need funds, it will be difficult for you to successfully track and report assets and liabilities, as well as expenditures and revenues by key funding sources at the level of detail and with the flexibility required without a system specifically designed for nonprofits.

SFAS 117 created another tracking and reporting requirement above and beyond what you were already doing. With all the tracking and reporting requirements you're already faced with, a good fund (nonprofit) accounting system becomes more imperative than ever. A good fund accounting system should accommodate an organization's internal needs to track by key funding sources as well as grouping funding sources then reporting them according to SFAS 117. In the MIP NonProfit Series for Windows fund is an optional account segment you can choose to use, so you can track and report the exact way your organization needs.