



Fund Accounting vs. Commercial Accounting for Nonprofits

Why growing nonprofits need true Fund Accounting for secure financial management

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What is Fund Accounting?

Commercial organizations have accounting systems that measure product, division and company performance by gain and loss of profits. Accounting systems for nonprofit organizations (and sometimes government agencies) only begin by measuring incoming and outgoing monies—they must do much more. Nonprofits have social and legal responsibilities that extend beyond the balance sheet. They must also carefully track and report on separate sums as they move through their programs in the forms of “funds.” Major donations and grants are commonly given with a set of specific and unique requirements, restrictions and responsibilities. The associated funds are either “restricted” or “unrestricted.” Failure to demonstrate that “restricted” funds have been used correctly can have some serious organizational consequences, including termination of executives, loss of funding and worst case, loss of tax-exempt status. This type of accounting for noncommercial entities is called fund accounting. Solutions that deliver fund accounting like the Sage MIP Fund Accounting product line are specially designed to help nonprofits meet those tracking responsibilities and handle the special requirements that may come with each new source of funding.

How does fund accounting work? Consider this example: A food bank has received a grant specifically for helping children get enough milk and a major donation from a corporate foundation for building a soup kitchen. The food bank will need to track how those funds were specifically used for milk or children’s programs to report back to one grantor, and will need to track the soup kitchen building fund separately, as milk-program donors may object if their monies are used for roofing material. Fund Accounting is set up to track and report on the specific projects separately to each set of donors, as well as together for overall organizational outlook reports. This is a very common situation in the nonprofit sector — health funds may be restricted for preventive care only or technology funds commonly may be used only to purchase software — not pay the light bill. Donors and grantors also want to review not only that their donated monies are restricted as requested, but to also review the overall use and results from the funds. Nonprofits cannot pool their money into general operations the way commercial businesses do, and often it is critical to track each different fund source to each relevant activity, so donors and granting agencies can see exactly where their money went, which encourages them to continue their support in following years.

As the example above illustrates, reporting is a critical issue and function for these organizations, as their continued funding can depend on reporting accuracy. Also, organizations that are able to provide this detailed level of reporting have a much better chance of seeing their funding and the scope of their mission increased.

The features of fund accounting largely reflect the importance of flexible but accurate reporting for nonprofits. For example, fund accounting is also different from traditional business accounting in its time period flexibility. Each grant and donation may be applied for and granted annually, but each funding agency or organization may function on unique timetables that probably do not correspond with those of the other grants. So, while commercial accounting often assumes a fiscal year that ends in the same month each year, nonprofits often have to report to several different audiences, with different information requirements and reporting timelines. One foundation may want yearly reports that span the period from January 1 to December 31, while another requests them to reflect from July 1 to June 30. Yet another may request biannual reports. Thus the ability to track and report across different time periods is critical for nonprofits and is a key attribute of solid fund accounting.

Nonprofits also require a great deal of flexibility in the types of reports that they must produce. Nonprofits have to comply with the stringent reporting standards of the Financial and Governmental Accounting Standards Boards (FASB & GASB), as well as the private and public granting agencies that require detailed reports in their own unique formats. If they want to win more donations, they may need to create compelling reports for potential donors. Each of these audiences and the reports that are specific to them will have unique requirements. They need access to sophisticated, audit-level reports for good accounting, as well as simple, high-level reports that can be understood by less accounting-savvy audiences. Flexibility of detail and presentation is critical in solid fund accounting. Graphing and charting capabilities to ease presentation of complex financials are also extremely helpful to nonprofits.

In addition, nonprofits can be limited to the grants that they can pursue and maintain, due to the time investment required for the financial administration for each grant. Any tool that helps streamline the tracking and management of grant processes, budgets and required reports can enable an organization to seek additional funds.

Many nonprofits use commercial accounting products initially, but once most organizations have multiple funding sources, they find that off-the-shelf accounting software will not meet their special tracking and reporting requirements. The process can grow impractical and difficult to maintain. At worst, it can open the door to costly errors and complex audits. Good fund accounting meets the complex fund tracking and flexible reporting requirements that are vital to a nonprofit's continued ability to serve its community.

About Sage Nonprofit Solutions

The Sage Fundraising and Sage MIP Fund Accounting software product lines from Sage Software have been providing the specialized management needs of nonprofit organizations and governmental agencies for over 20 years. Currently over 9000 not-for-profit organizations rely on Sage nonprofit solutions.

About Sage Software

Sage Software (formerly Best Software) offers leading business management software and services that support the needs, challenges, and dreams of more than 2.4 million small and mid-sized business customers in North America. Its parent company, The Sage Group plc (London: SGE.L), supports 4.5 million customers worldwide. For more than 25 years, Sage Software has delivered easy-to-use, scalable and customizable software for accounting, customer relationship management, human resources, time tracking and the specialized needs of accounting practices and the construction, distribution, manufacturing, nonprofit and real estate industries. For more information, please visit the Web site at www.sagesoftware.com/moreinfo or call (866) 308-2378.

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